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# ***JPRS Report***

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# **China**

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# China

JPRS-CAR-88-044

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5 AUGUST 1988

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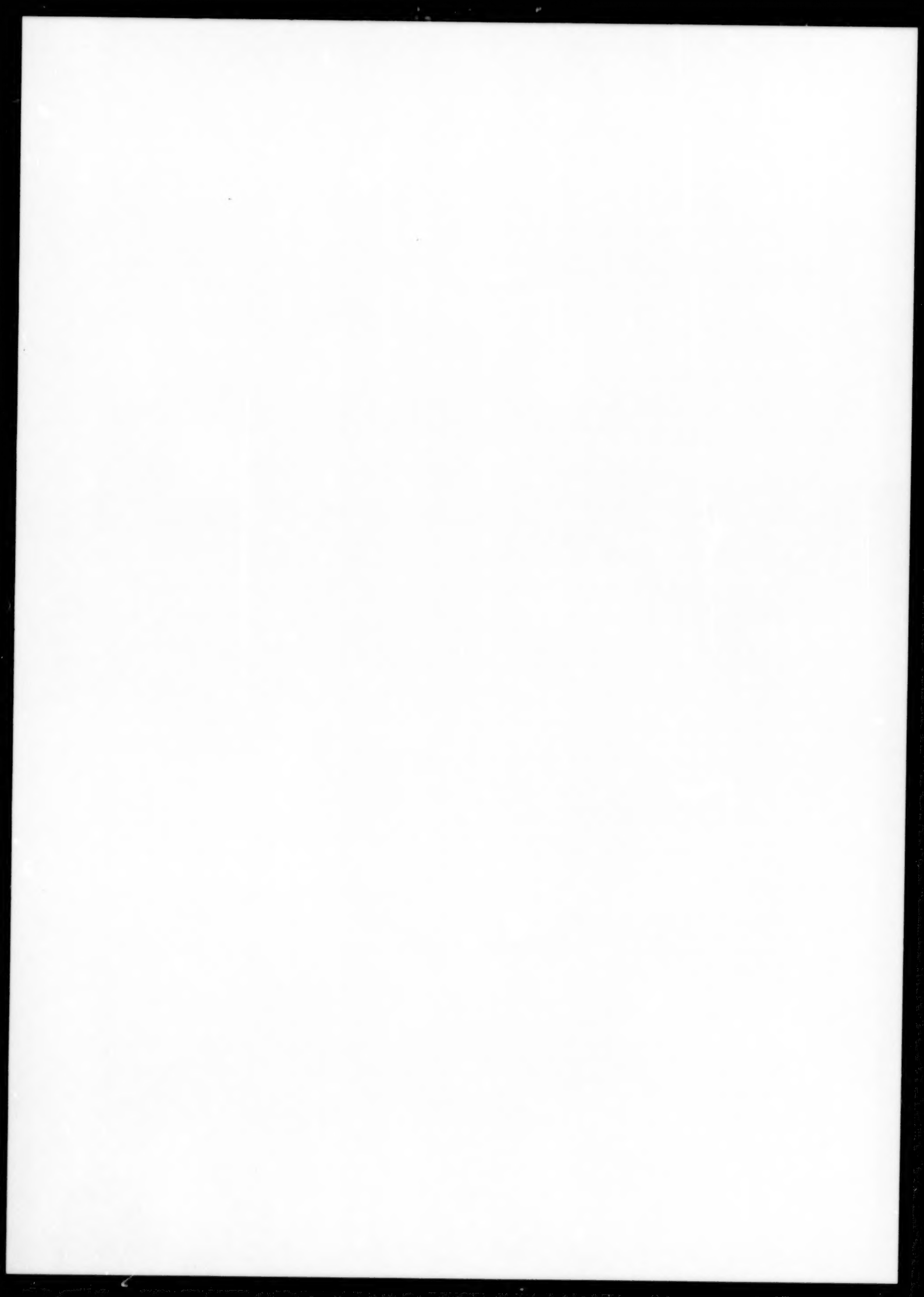
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## NATIONAL AFFAIRS, POLICY

### Enterprise Law Draft Amendment Issues

40060324 Beijing ZHONGGUO JINGJI TIZHI GAIGE  
[CHINA ECONOMIC SYSTEM REFORM] in Chinese  
No 4, 23 Apr 88 p 36

[Article by Li Tiegang [2621 6993 0474]: "Enterprise Law Draft Amendment Issues"]

[Text] The 8 years of hard work and many deliberations and modifications that it has taken to draft and pass the Enterprise Law show the cautious approach that China takes toward legislation and that the idea of reform has continued to strike root in the people's hearts. After a law is issued, it is up to the state to ensure that it is enforced. A full and accurate understanding of a law is a precondition for ensuring its enforcement. The understanding in the past few years of certain basic issues pertaining to the Enterprise Law has certainly not been unanimous in either theoretical circles or the departments that did the actual work. It should not be thought that people's understanding of a law will spontaneously become unanimous after it is issued. A brief review of the amendments that have been added to the Enterprise Law draft since it was issued may contribute to its understanding.

#### I. The Issue of the Opportune Time for the Enterprise Law To Appear

There have always been two distinct views on this issue. Comrades in most departments and enterprises think that the 9 years of economic reforms that have been carried out and the theoretical interpretation of a series of planned commodity economy issues that was made by the 3d Plenum of the 12th CPC Central Committee and the 13th CPC Congress have provided a good basis on which to formulate and issue the Enterprise Law. Moreover, they think that the time is ripe for the Enterprise Law to appear because it has been being enacted for 8 years and its draft has been through many deliberations and modifications.

The other view is that China's economic reforms are being developed in depth and the final framework of the new economic system has not yet been established. There is a contradiction between the constant intensification of reform and the relative stability of the law. Hasty legislation might hamper the reform initiative and thus, the time is not ripe for the Enterprise Law to appear. Provisional regulations should be drafted first so that enterprises will have something to go by.

These two distinct views both touch upon the issue of what sort of enterprise law China should formulate under present conditions. As a basic law for enterprises, the Enterprise Law is limited to certain basic enterprise issues alone and cannot try to resolve all enterprise issues. It is the basic principle and point of departure for resolving other enterprise issues and not a prescription

for curing all enterprise ills. It is unrealistic to assume that once the Enterprise Law appears, enterprise vitality will be improved immediately and all enterprise-related issues can be resolved readily. Legislation must be aimed at real enterprise issues. Although enterprise vitality is now somewhat better, the situation has certainly not basically changed in which "it is hard to run enterprises and be factory directors," "enterprises have too many duties and too few powers," and "there are too many 'bosses' and too heavy burdens." Since there is no law to go by and the legal status of enterprises and factory directors is unclear, legitimate enterprise rights and interests cannot be ensured and factory directors cannot exercise their authority. This is why enterprise factory directors, party committee secretaries, and labor union chairmen have made loud appeals for the Enterprise Law to appear as soon as possible.

On the other hand, economic reform is in a period of transition from the old system to the new in which frictions and contradictions are very sharp. If the reforms that have been achieved are not promptly established legally and the transition is not speeded up, certain aspects of the old system that have stepped down from the stage of history may eventually be revived and make reform more difficult. An extended period of confrontation between the two systems might result in a long period of unstable socio-economic relations and disrupt the growth of the productive forces and the stability and unity of society. A broad view of world history shows that reform has always been closely connected to legislative changes. On one hand, legislation changes and negates old institutions and practices and, on the other, sets up new ones. Reform is a complex social system engineering project and can certainly not be accomplished quickly. It is of course inconceivable that the enactment of legislation can wait until after reform is completely successful. Both reform and legislation are processes of transition from imperfection to perfection and reform cannot "be accomplished in a single bound." Legislation in a period of reform and opening can only be enacted point by point as allowed, and whatever is prohibited must be temporarily put aside. This sums up China's legislative experience in the past few years. When we say that the time is basically ripe for China's Enterprise Law to appear, we mean that the Enterprise Law clarifies certain basic issues pertaining to China's enterprises and not that it clarifies all enterprise-related issues. Others feel that the time is not ripe for China's Enterprise Law to appear because it is too general and insubstantial. Comparative studies of various countries' legislation can help us to use advanced foreign ideas for reference to improve our legislation. But using for reference is not copying indiscriminately. Since all countries have different socio-economic, political, and cultural institutions, their legislation should naturally be different. Whether the time is ripe for a law to appear should depend not on the complexity of the legal document alone, but mainly on whether its provisions are in line with the demands of socio-economic relations. Even though China's Enterprise Law is concise,



it still sums up over 9 years of reform experience, is comprehensive, stipulates all enterprise relations, and is standardized.

## II. The Issue of Relations Within Enterprises

The economic relations that are regulated by the Enterprise Law can be divided into two types. The first are external enterprise relations, such as those between the state and the enterprise and those between enterprises. The second are relations within enterprises, the major ones being those between managers and staff members and workers and those between factory directors and organizations such as worker congresses, labor unions, and the CYL. Since the Enterprise Law draft was issued, certain amendments on relations within enterprises have been added to it in line with the views of various localities and departments.

1. The Status, Rights, and Roles of Staff Members and Workers. Comrades in certain departments and localities felt that the Enterprise Law should focus on arousing the initiative of two groups. It should take care to arouse the initiative and ensure the legitimate rights and interests not only of managers, but also of staff members and workers. The Enterprise Law should reflect the spirit of the 13th CPC Congress to "coordinate the authority of managers with the status of staff members and workers as the masters." Thus, a clause was added to Article 8 of the General Rules to "ensure the status of staff members and workers as the masters of their enterprises and safeguard their legitimate rights and interests." In addition, Articles 49 and 50 were added to Chapter 5, supplementing the rights and duties of staff members and workers and making the preceding provisions of the General Rules more specific.

2. Relations Between the Factory Director Output-Related Responsibility System and Democratic Management of Staff Members and Workers. Along with emphasizing the implementation of the factory director output-related responsibility system and acknowledging the factory director's crucial status in and overall responsibility for the enterprise, the Enterprise Law should reflect a spirit that conscientiously ensures democratic enterprise management. Worker congresses are regarded as the basic form of democratic enterprise management by staff members and workers. Their rights can be divided roughly into three types: the right to examine and approve major policy decisions that concern enterprises, the right to make decisions on welfare services for staff members and workers, the right to supervise enterprise leaders. In order to respond to the call to coordinate the authority of managers with the status of staff members and workers as the masters, both the decision-making power of factory directors and the right of staff members and workers to examine and approve must be ensured on major enterprise policy decisions that affect

enterprise growth and the rights and interests of the state and staff members and workers. To this end, appropriate amendments were added to Article 52, Section 1 of the Enterprise Law.

3. The Status and Role in Enterprises of Labor Unions and the CYL. The issue of the status and role in enterprises of mass organizations, such as labor unions and the CYL, is closely related to the status of staff members and workers as the masters. Comrade Zhao Ziyang pointed out in his report to the 13th CPC Congress that, "All mass organizations should be able to work independently and on their own initiative in line with their respective characteristics and, along with safeguarding the overall rights and interests of the people throughout China, should be able to better voice and safeguard the particular rights and interests of the groups that they each represent." Since labor unions are China's largest mass organizations, developing their role will be a key link in building a democratic political system in China. More than 80 percent of the staff members and workers in China's state-owned industrial enterprises belong to labor unions and many of the democratic rights of staff members and workers have been acquired through the actions of labor unions. It was essential to make clear provisions in the Enterprise Law on the status and role of labor unions in order to ensure the democratic rights of staff members and workers and make enterprise management more democratic. In discussions of the Enterprise Law by all the people, CYL organizations in all areas also called for acknowledgement in the Enterprise Law of their status and role in enterprises. Young workers now account for more than 60 percent of the staff members and workers in state-owned enterprises, up to 80 percent of those in the forefront of production, and most enterprise team and group foremen jobs in many trades are held by young people. Enterprise CYL organizations have a strong appeal to vast numbers of young workers and functions and roles that cannot be replaced by other organizations. Thus, two articles on labor unions and the CYL were added to the General Rules of the Enterprise Law.

4. On the Issue of Restricting the Authority of Factory Directors. In informal discussions, some people felt that after carrying out the factory director responsibility system and along with endowing factory directors with the proper authority, it would be necessary to tighten the restrictions on factory directors. In real life, some factory directors have certainly abused their authority and encroached on the legitimate rights and interests of staff members and workers. This is strongly related to the absence of proper restrictions on their authority. The Enterprise Law draft clarified the authority of factory directors but its provisions on their obligations and duties were very incomplete. Thus, the following provision was made in Article 46 of the Enterprise Law: "Factory directors must rely on staff members and workers in fulfilling all enterprise obligations according to the provisions of the law, support the work of worker congresses and labor unions, and implement decisions made according to law by worker congresses."

5. On the Issue of Enterprise Party Organizations. A very controversial issue that has been encountered in the course of drafting the Enterprise Law in the past few years is whether it should include a section on party organizations. Unanimity of opinion was not achieved in the national discussions. One view held that it would be hard to stipulate the role of primary party organizations in a legal document. The other view held that since China's enterprises have long carried out a factory director responsibility system under the leadership of party committees, the status and role of party organizations should be clearly stipulated in the Enterprise Law so as to facilitate a smooth transition to the factory director output-related responsibility system. This would prevent intervention by party organizations in routine enterprise production decisionmaking and ensure that factory directors could truly accept overall responsibility. When the Enterprise Law draft was being amended, the latter view was adopted. But each particular role of party organizations could not be specified in the Enterprise Law because how party organizations could operate after the enterprise leadership system was changed still involves many issues that are pending conscientious study and are temporarily uncertain. Thus, the Enterprise Law makes only general provisions on the role of party organizations.

### III. The Issue of External Enterprise Relations

The standardization of external enterprise relations is another important section of the Enterprise Law. The major amendments that were added to this section are as follows:

1. On the Issue of How Factory Directors Are Chosen. Based on the views of certain departments and enterprises, Article 42, Section 3 of the Enterprise Law draft was amended as follows: "Factory directors who are elected by enterprise worker congresses must be approved by the responsible government departments. Factory directors who are selected by appointment or advertisement by responsible government departments must solicit opinions from staff members and workers." This provision pertains to factory directors in state-owned enterprises. Since these enterprises are state-owned, one of the powers and functions of state ownership is the appointment of factory directors. In addition, since ownership was separated from management authority, the state does not run enterprises directly but engages factory directors to lead all staff members and workers in running them jointly. Staff members and workers are best qualified to speak on enterprise conditions, and responsible government departments should solicit their opinions when appointing factory directors. This shows that staff members and workers are the masters and are necessary for building a democratic political system at the basic level.

2. Relations Between Enterprises and Local People's Governments. Development in depth of urban economic reform has necessitated a rapid transformation of the

government's economic management function from direct management of enterprises to serving them. Since piecemeal relations cannot be dismantled quickly, the Enterprise Law clearly stipulates that relations between enterprises and local people's governments should help enterprises devote themselves to developing production and gradually reverse the situation in which enterprises "handle social welfare services." Article 57 of the Enterprise Law stipulates that "People's governments above the county level should provide the goods and materials needed by locally-run enterprises, coordinate relations between enterprises and other institutions in their areas, and strive to do a good job of handling public welfare services that affect enterprises."

3. On the Issue of Apportionment of Enterprise Resources. The State Council has issued repeated injunctions in the past few years against apportionment of enterprise manpower, material, and financial resources, but they have failed time and again and the situation has even worsened. This has seriously hurt the life and growth of enterprises. The Enterprise Law draft contained anti-apportionment stipulations in several places but did not stipulate clearly what apportionment meant. In order to vigorously curb apportionment and ensure management authority to enterprises, Article 33 of the Enterprise Law stipulates that "Except where otherwise stipulated by law or regulation, all calls in any form by any organization or institution for enterprises to provide manpower, material, or financial resources is apportionment."

4. The Issue of Enterprise Foreign Trade Rights. Since the Enterprise Law draft was issued, loud calls have been made by certain foreign exchange-earning enterprises for provision in the Enterprise Law on enterprise foreign trade rights. The CPC Central Committee has also proposed an economic strategy of participation in the "great international circle" and "large-scale foreign trade." Thus, a provision should be made in the Enterprise Law that enterprises enjoy foreign trade rights. But certain rules and procedures are necessary to ensure the implementation of a unified foreign policy. On enterprise foreign trade rights, the Enterprise Law stipulates that "Enterprises have the right to sign contracts based on stipulations by the State Council and negotiations with foreign businessmen." This stipulates, on the one hand, that enterprises have foreign trade rights and, on the other, that they must carry them out according to State Council stipulations. This provides for vigor without disorder.

### IV. The Issue of the Enterprise Law Applicability

The Supplementary Articles in Chapter 8 of the Enterprise Law draft stipulate its applicability. But since economic reform is being constantly intensified, it should not be applied indiscriminately to certain issues, such as the system of enterprise leadership. Neither the system that is now being used by some large enterprises, such as the Capital Steel Corporation, nor the stock

system that was set up in some state-owned enterprises belong to the factory director output-related responsibility system. If one leadership system was required across-the-board in the Enterprise Law, the leadership system that is being used by enterprises such as Capital Steel would be illegal. This would violate the principle that reform must carry out experiments. In addition, since enterprise system reform is constantly being intensified, management forms, such as the contract management responsibility system and the lease management responsibility system, have become the main forms of separation of power. More and more enterprises are beginning to use these management forms. Since contracted and leased enterprises are different from other enterprises in areas such as their leadership system and their relations between the state and managers, the law should allow them adequate management leeway and take a position that combines principles and flexibility. Articles 65 and 66 of the Enterprise Law further clarify the issue of its applicability.

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#### **Problems of Commodity Price Reform**

40060354 Beijing JIAGE LILUN YU SHIJIAN  
[PRICE: THEORY AND PRACTICE] in Chinese  
No 3, 20 Mar 88 pp 19-24

[Article by Tian Yuan (3944 3293): "Several Questions Concerning the Expansion of Price Reform"]

[Text] After 9 years of reform, drastic changes have occurred in the previously rigid and highly distorted price structure and system, a multi-level, multi-factor pricing mechanism is appearing in its embryonic form, and the distribution of China's resources has been regulated to a large degree by price signals. The problem we have now is that because China's economic reform is being carried out gradually, new and old factors coexist in the working process of pricing mechanism and the pricing of a subject or a product is based on two different standards which are both incomplete, thus giving rise to a series of problems which are difficult to resolve. The immaturity of the new price mechanism corresponds to that of the new economic system as a whole. Practice has proved that it is impossible to carry out price reform before carrying out reforms in other fields, that reforms of all fields condition and promote each other, that the number of new reforms revolving around the new economic system is increasing, and that goals of the price system and the economic system as a whole are becoming increasingly clear each day, thereby narrowing the gap between reality and goals.

One important experience gained in over 9 years of practice in price reform is that we should better our understanding of reform in the practice of reform. On this issue, we should not blindly worship any concept or theory that appears to be authoritative because reform in a socialist country is a new type of social practice and nobody can possibly draw an unchangeable conclusion

from limited practice in the past, still less design a "model" and force it on practice. Based on previous practices in China and other countries, we should admit to a certain extent that some of our assumptions are valuable at present and therefore may be adopted. However, we must clearly understand that we should continue to familiarize ourselves with practice so as to revise the policies and goals we have designed. In this sense, the process of reform is a process in which theory guides the continuous development of practice as well as a process in which practice continues to perfect theory. Based on this understanding, when carrying out price reform, we should consider problems in practice as the focusing point in the study of the line of sight, try to find policy ideas by comparing and analyzing domestic and foreign theories and practices to solve the above problems, and design policies accordingly to better China's economic mechanism, continue to improve the distribution of economic resources, and use reform to accelerate the development of productive forces.

#### **Problem One: Price Reform and the Readjustment of Economic Structure**

In a commodity economy, price is a guiding signal for the distribution of resources. Price, whether it is high or low, rational or not, can always serve as a guideline for the distribution of resources. Namely, price structure spurs on the readjustment of economic structure. Conversely, economic structure can to a certain extent determine the balance and imbalance of price structure. During the initial period of China's price reform, there was a serious imbalance in the structure of agriculture, light industry, and heavy industry in the national economy. At that time, price readjustments had a very clear goal, that is to help accelerate agricultural development and readjust the structure of agriculture, light industry, and heavy industry. The continuous price increases of farm products between 1979 and 1984 provided financial support for the implementation of agricultural production responsibility system, reversed the stagnant situation of agricultural input and output, and brought about unprecedented progress. This has to a certain extent solved the problem of extremely backward agriculture and helped China's economy leap over the development stage in which the goal is to feed and clothe 1 billion people and begin the march toward the goal of comfortable living—\$800 per-capita income.

Under the new stage of economic development, we need new ideas to handle the relation between China's price and economic structure. In view of the fact that China has a vast territory and that local economic and natural conditions differ substantially, not only should we continue to stress the importance of improving economic structure by readjusting price structure but we also should pay special attention to improving price structure through the readjustment of economic structure. Since China's economy cannot withstand too many price increases, we must treasure the annual opportunity in which policy decisions are adopted to readjust prices.



We should set two principles for this. First, we must give the opportunity of price readjustment to the departments whose growth has contributed most to the national economy as a whole. Second, for all pricing problems that can be solved without price readjustments, we should vigorously seek policies not related to prices.

Judged from the reality, "the departments whose growth has contributed most to the national economy as a whole" might be power, communications, and transportation departments because the increase of China's macroeconomic returns depends to a large degree on that of industrial returns. Currently, China's power shortage and traffic congestion cause many local enterprises to remain in the stage where they "close for 2 and open for 5 days" or even "close for 3 and open for 4 days." According to the calculations of the author of "China in the Year 2,000," the shadow price of communications and transportation is the highest among all departments. This has proved indirectly that developing communications and transportation departments will yield most returns on the national economy as a whole. Since the beginning of this year, the price of electricity has increased slightly, which has given an impetus to the development of power industry. The price of electricity should continue to increase in the future. In the past few years, the prices of communications and transportation have not shown marked increases and especially the fees of railroad transportation have remained so low that many ill consequences have resulted. Their expressions are: 1) Demand greatly exceeds supply in railroad transportation and yet prices remain on the low side and freight cannot find due expression in the cost of production, resulting in the phenomenon that many products whose profit margin is low when sold to a remote area are transported by rail while those whose profit margin is high when sold to a remote area are rejected. The unduly low prices of railroad passenger tickets have caused the demand to expand excessively, increasing the national circulation of population and creating confusion in ticketing, loading, and servicing. Maintaining traffic order has become very difficult and the congestion of hard-seating trains has become unbearable in busy sections of the railway. 2) Due to the unduly cheap fares of rail transport, railroads have been inundated with products waiting to be transported and the development of more expensive water transport has been seriously suppressed. The cheap fare has caused a serious shortage of rail transport and at the same time prevented water transport, which has great flexibility in supply, from being fully utilized. Relevant departments warned that if we do not solve the problem of rail freight now, China's Chang Jiang water transport will be in the danger of bankruptcy. According to above analysis, only by solving the pricing problem of this department can we bring about great development in communications and transportation, form a rational transport demand structure, and accelerate the readjustment of China's local economic structure. Therefore, we should give priority to solving

the pricing problem of communications and transportation. On this issue, we must scientifically distinguish between the short-term and medium- and long-term effects of price reforms. We can predict that the short-term effect of freight increases lies in the field of demand. Transportation reform can restrain irrational demand as well as readjust the variety and regional structure of demand, thereby achieving macroeconomic results and alleviating the contradiction between transport forces and transport capacity. Medium- and long-term effects of freight increases are mainly to increase the supply of comprehensive transport capacity, speed up the growth of supply sources of rail, water, highway, and air transport capacity, and achieve a fundamental balance between transport forces and transport capacity. Therefore, the price reform of transportation should be included in the agenda, not ignored or put off permanently.

Among China's railroad problems, many appear to be the low-price problem but actually belong to the low-profit problem. The so-called "low-price" problem refers to the situation in which the production cost of a business is close to or even higher than the price set by the state due to resources, technology, and other objective conditions, for under this situation the only solution to the problem is to raise prices. The so-called "low-profit" problem refers to the situation in which the profit rate of a certain business is lower than the average level of society but this situation is caused mainly by man-made factors, not resources and technological conditions. In other words, the pricing problem under this situation is merely a result of irrational economic structure or management. For instance, among some industrial businesses in China, the production costs of backward enterprises are 50 percent or even 100 percent higher than those of advanced enterprises, and the average profit level of the industry as a whole is lower than the average level of society. Based on the principle of pricing according to average profit, the price level of such industry should be raised still higher. But, if we adopt the practice of expanding the market quotas for the products of advanced enterprises, the profit level of such industries will be close to or even higher than the average level of society. In many industries where the duplicate construction problem is serious, economies of scale are poor, and the profit level is low, an important way to improve price structure is to vigorously develop the market for enterprise property rights, provide conditions for outstanding enterprises, which have high managerial standards and low production costs to merge with backward enterprises, and improve the organizational structure of enterprises. In China's agricultural and side-line production, we can also adopt various policy measures according to the above principle to gradually rationalize the regional distribution of different farm products. In the past few years, with prices staying at the same level, sugar cane production declined in Guangdong but increased in Guangxi and the number of live hogs decreased in Shanghai but increased in Sichuan, which explains that the regional structure of agricultural

production is being readjusted. The deeper meaning of this signal is that centralizing the production of all products in areas where production costs are low can reduce the pressure caused by price increases and speed up the development of production. Ignoring the potential effect on readjusting economic structure and hoping only to raise prices cannot improve the distribution of natural resources nor find a fundamental solution to the pricing problem of China's farm products. This shortcoming still exists in some policy studies and it should call for more attention from the leaders of relevant departments.

**Problem Two: Ways To Design a Mechanism or System Under Which Prices Are Regulated by the Government Based on Markets**

The goal of China's economic reform is to establish a system under which "the state regulates the market and the market guides enterprise." This system obviously is one that links government regulation to the mechanism of commodity economy, whereas under our current system the two are often separated or even set against each other. As a result, the whole economic operation has many obstacles and contradictions and government regulation often remains in a very passive situation, which is not good for economic development and must be gradually reversed.

Judged by the goal of China's price reform, except for a few monopolized industries where prices should be set by the state, most products of industrial departments may be gradually decontrolled. Since industrial production is more competitive, it is feasible to allow more price and interest coordination problems in this regard to be decided by markets. In agricultural departments, however, due to the salient features of agricultural production, different countries have different practices in price and interest coordination, which are all very complicated. In order for agricultural development to enter a benign circle, a complete mechanism and system of government price and interest regulation based on markets is indispensable according to the experience of agriculturally developed countries. The characteristic of this mechanism and system should be organically linking government compensation, farmers' income, and state list prices to market prices to meet various demands such as national strength, market fluctuation, and steady farmers' income, thus providing both control and flexibility. Ideas and methods used to design U.S. policy in agricultural regulation are worth our attention.

According to experts at the Economic Research Service under the U.S. Department of Agriculture, the U.S. government takes the study of agricultural policies very seriously and has used large amounts of manpower and material resources for this purpose. The Economic Research Service under the U.S. Department of Agriculture alone has over 600 employees. On the basis of extensive research and long-term practice, they have formed a mechanism and system of government price

regulation based on markets. Although some parameters of this system cannot be established before repeated discussions and comparisons by different interest groups, the system itself has been highly simplified. The interrelations among "target, loan, and market prices" form the framework of the basic policy on agricultural regulation for the U.S. government and its serviceability and adaptability are highly commendable.

The most important relation in this system is the relation between "loan prices" and "market prices." The interrelation between the two on the annual market determines the behavior of the government and farmers. "Loan prices" are accounting standards American farmers used to get government loans before the process of production. For instance, the loan price of corn is the standard corn farmers used to calculate the amount of loans they can get from the government. Because the level of such prices has a great impact on farmers' income and government expenditures, the right to decide on loan prices lies in the U.S. Congress. The decision of loan prices is a prolonged process. Different interest groups collect large amounts of all kinds of information and make up all kinds of arguments to carry out heated debates in the Congress to demand higher or lower loan prices. After many debates, loan prices will be considered an important item on a farm bill to be passed at the Congress. Since extensive research has been conducted, such prices have in fact basically coordinated the interests of farmers with those of other social groups. In the agricultural economy of the United States, loan price is a very important parameter which has three kinds of relation to market prices. The first relation is that market price is higher than loan price. This means that farmers may use earnings from the sales of farm products to pay back the capital and interests of state loans and still have some profits left. The second kind of relation is that market price is lower than loan price. This means that farmers suffer losses because their earnings from the sales of farm products are not enough to pay loans. Under this situation, farmers are allowed to deliver all their grain to the government and be exempted from the capital and interest payments of loans. This stipulation is, in essence, to shift the risk of agricultural production from farmers to the government, which takes the risk of agricultural production by relying on abundant resources of state revenue. The third kind of relation is that loan price is the same as market price. Farmers break even; no gain, no loss. This situation is actually an accidental phenomenon and there are usually only two kinds of relations. The establishment of clear relations between loan and market prices and the adoption of corresponding policies on government regulation have formed a flexible regulatory mechanism based on the market, which has become an important factor in the steady development of agricultural production.

The second important relation in the mechanism and system of agricultural regulation by the U.S. government is the relation between "target prices" and "market prices." Target prices are generally higher than loan

prices and the main objective of such a policy is to solve the agricultural overproduction problem of the United States, focusing on regulating the income of farmers participating in the fallow program. The U.S. government stipulates that only those farmers who allow 20 percent of their farmland to be fallow can enjoy the benefits of the target price policy. The concrete practice of this policy is: The average output of the past 5 years from 80 percent of a farmer's land times target price, or current year's output from 80 percent of a farmer's land times market price, equals farm subsidy. In this policy formula, target and market prices to a certain extent determine farmers' income. Farmers participating in the fallow program can always get more income than target price multiplied with the 5-year average output of 80-percent farmland. If market price is higher than target price, farmers can get even more income. As far as the government is concerned, the subsidies are linked to output. In other words, as output increases, the subsidies will exceed demand, market price will be lower than target price, and the subsidies will increase; as output decreases, supply will be unable to meet demand, market price will be higher than target price, and the subsidies will decrease. Because farmers participating in this program must first agree to fallowing 20 percent of their farmland, the internal mechanism of this policy system has already put a restraint on the increase of output, namely limiting the increase of subsidies. This is a very ingenious "policy apparatus" which benefits both the state and farmers and is obviously useful to a country suffering from agricultural overproduction.

In the agricultural regulation mechanism and system of the U.S. government, another practice that is worth our attention is "goods for subsidies," under which the U.S. government, instead of paying cash, offers farmers participating in the fallow program subsidies in kind according to market prices. I have visited a corn farmer in the United States. When the market price of 1-liter of corn was 32 cents lower than the target price, this farmer, according to the above mentioned compensation method, obtained from the government a corn voucher worth \$5.365, which can be sold on the market to corn companies or other farmers in exchange for \$5.365 in cash, thus saving the government cash expenditure. According to the officials of the U.S. Department of Agriculture, in order to encourage merchants to promote sales of farm products on international markets, the U.S. government has also adopted the "goods-for-subsidies" method. For instance, if a certain farm product sells for \$59 per unit on international markets and for \$100 to domestic procurement departments, merchants may sell such product for \$50 abroad to promote sales of farm products and the government will subsidize the merchants with \$50 worth of farm products, but not cash. This practice, like the other one, is the government "selling" back to the market the grain it collected from farmers as payments on loans, thus turning idle money into working money. There is a lot we can learn from this practice.

This mechanism is applied by the US government to seven or eight major farm products including grain, cotton, and tobacco, which has played an important part in stabilizing production and farmers' income. Since the national conditions of China and the United States are different, we should not copy the actual practices of the United States. But, as a country dominated by the market economy, the United States has managed to successfully design and effectively apply a policy regulation mechanism that links government and market regulations. To this, we cannot but admit that the ideas behind the design really deserve our study. The price reform of China's agriculture is also focused on the regulation of interests. However, under the current policy, regulation is carried out mainly by taking from, instead of giving to, farmers. As a large part of the farmers' economy is subject to changes on markets and under certain risks, it is very difficult to avoid fluctuation in agricultural production. Comparison of practices in different countries and our own experience have proved that without a carefully designed, easy-to-apply policy regulation mechanism and system, there will be no successful agriculture and economy.

### **Problem Three: We Should Develop China's Futures Markets**

In the past 9 years drastic changes have occurred in China's rural economic system. The extensive implementation of agricultural production responsibility system has made farmers commodity producers who are responsible for their own profits and losses. The reform of state monopolized and assigned procurement has enabled the market mechanism to infiltrate many areas of rural economy. Except for grain and cotton which are procured under contracts, all farm products are regulated by markets. These changes have, on the one hand, shattered the rigid system, injected energy into the economy, and created many alternatives for farmers and, on the other hand, brought the fluctuation of a market economy into the system of agriculture. In the past few years, due to the combination of various factors, such as natural, economic, technological, and policy conditions, the production and prices of a series of major farm products such as grain, cotton, hogs, ramie, jute, bluish dogbane, and rabbit fur have witnessed violent fluctuation. The fluctuation of agricultural production has had a major impact on agricultural production and the national economy as a whole. In 1987, the decline of national hog production and enormous price increases seriously affected the daily life of urban residents. Seeing that supply was far behind demand, all localities scrambled to adopt various preferential policies to promote hog production. But, they did not realize that the logic of China's economy is just the opposite. When a problem is at its worst, the problem itself has already been solved; further stimulation could only cause adverse effect and aggravate fluctuation. We can predict that by the end of this year or the beginning of next year, hogs will be difficult to sell again because the supply has been overstimulated whereas hog farmers, without access to the



nation's future demand and supply information, can only act according to the signal of high prices provided by spot markets. Their reaction to spot market is the main cause for the sharp increases and decline in the prices of farm products. Repeated occurrence of such fluctuation in a nation's economy explains two things. One is that markets are underdeveloped; the other, that practice has set forth the task of establishing futures markets.

"Futures" are the opposite of "spots." Spots are merchandise currently sold or purchased by any producer or consumer whereas futures are merchandise to be sold or purchased in the future (1 month or 1 year from now.) Futures transaction is different from a forward contract, for the latter refers to a contract under which a buyer and a seller agree to trade a certain amount of merchandise at a negotiable price at a certain time in the future. Futures are commodities with fixed prices which are set through competition at trading centers, the futures contracts of every unit may be transferred several times at trading centers, and the prices of futures may be changed by the buyer and seller during each transfer until the contracts expire.

Futures trade is a product of the development of commodity economy as well as an internal balancing mechanism of commodity economy. The very first futures trade stemmed from the effort to eliminate market fluctuation. In the 1940's, American farmers, after each harvest, generally had to rush all of their products to the Chicago market as soon as possible and, as a result, all warehouses would be filled up in a hurry and surplus products would be abandoned on streets, causing the prices of farm products to plummet. A few months later, farm products would be in short supply again and prices would go up. The producers as well as the consumers were suffering from price fluctuations, and many merchants declared bankruptcy one after another. In order to prevent the confusion caused by unstable supply and price fluctuation, a better trading system—futures trade—thus emerged as the times required. The world's biggest futures exchange—the Chicago Commodity Exchange—was founded in 1848. First futures were considered forward contracts which bound both buyers and sellers in regard to the time, location, and amount of farm products to be traded. Soon afterward, buyers and sellers both felt that they needed a transferrable contract and that they needed to grade products and have a fair supervisor for the transaction. All these contributed to the standardization of futures exchanges in the 1960's. In the past decade, futures trading has become quite complex and sophisticated in regard to its form, content, mechanism, management, and technology. As a crucial component of the western commodity market and with greater links to money markets, it is now playing an extremely important role in economic operations.

In the western capitalist commodity economy, futures markets have a variety of functions and roles, some positive and some negative. However, its long-lasting

success should be attributed mainly to the fact that its leading role has always been boosting economic development. Among various unique functions of futures market, the following two are the most noteworthy:

1. Producers and manufacturers use futures to ensure output value and avoid the risk of price fluctuation. When a producer, take corn farmer for instance, begins sowing, he can not predict what the price will be after the harvest. If the future price is lower than the current price, he probably could not break even. Therefore, he hopes that the future price is high enough for him to cover his cost and make a profit. To achieve this, he may try to sell his future corn to buyers on futures market at a normal price which conforms to his expectation. If he succeeds, as a producer, he is obliged to sell his corn at a fixed price in the future. However, since the future price of his corn is set, he will be able to sell his corn to the contract holder at the same price even if corn prices drop in the future. By doing so, he can in fact shift the risk to futures market and thereby secure his own interest. As far as a manufacturer is concerned, buying and selling futures provides an insurance for stabilizing production cost and earning a normal profit. If an enterprise does not deal in futures, it would have to face the danger of closing down should the price of raw materials suddenly increase and production cost skyrocket in the future. If it buys futures in raw materials, it will be able to fix production cost at the same time and thereby make a normal profit and ensure the smooth progress of production.

2. The price of futures markets can truly reflect market supply and demand in the future, send out "advanced warnings" of supply and demand changes that will take place during different periods in the future, and regulate supply and demand accordingly. For instance, an increase in the forward price of a certain farm product should serve as a warning for buyers as well as a signal for producers to increase production. Conversely, a falling forward price can stimulate demand and remind producers that they should reduce production. If market price is unstable, it means that there are economic problems such as substantial increases in money supply and inflation. The reason why the price of the futures market can regulate supply and demand is because both buyer and seller use all channels and methods to analyze various factors that would affect the supply and demand situation between now and the future, for the accuracy of one's supply and demand information determines the amount of his profits. As a result, information turns into "money," thus speeding up the circulation of information and increasing the degree of transparency of market supply and demand. The law of the commodity economy is prices will be more stable as the market becomes more transparent, and production will be more normal as prices become more stable. The futures market reflects future supply and demand through forward prices and regulate current production supply and spot prices through the increase and decline of forward prices. According to experts at the New York Commodity Exchange, the variety of futures trading needs to be

approved by the U.S. government and the primary requirement for a commodity to enter futures trading is that the price of this commodity must be very unstable. However, once the commodity enters futures trading, not only its forward price will be stabilized, its spot market price will also be brought to the normal level. According to analysis, the key here lies in the fact that the supply and demand information on this commodity has been funnelled into the exchange and then spread all over the world, thus increasing the transparency of information, normalizing production and demand, and making it possible to stabilize prices.

Futures trade has not sprouted in China's economy, but some articles exploring this issue have begun to appear here and there in the past few years. Through various channels, China's economic circles are increasing their understanding of futures trade. I have visited the United States twice to study futures markets and I deeply believe that our economy can benefit from it. In order to eliminate violent price fluctuation of many major farm products, it is justified to select, at an appropriate time, some varieties to carry out the experiment of futures trade. It now looks like China's hog production is fraught with another crisis of overproduction. The basic cause is the lack of channels that can quickly and rationally collect and transmit information on current supply increase and future supply and demand relation. The spots market and ridiculously high prices made producers excited but they are actually being dragged into danger whereas government action also lacks correct information guidance, worsening the growing tendency of expanding hog supply. According to our study, the normal fluctuation rate of China's annual hog production is about 5 percent but its price fluctuation rate is close to 50 percent. Last year, national hog slaughter rate declined less than 3 percent, but the price increased substantially. Since hog production has gone up due to the stimulation of high price and based on the rule that the readjustment of hog price comes 1 year after that of grain price, hog price should be stable this year. Failing to see this point and continuing to stimulate supply will inevitably cause hog production to increase excessively and hog prices to drop by the end of this year or the beginning of next year. By then, farmers may not even be able to sell their hogs. Establishing a hog futures market on a trial basis under this situation not only can quickly centralize and spread supply and demand information to regulate production but also provide some farmers a place and method to ensure their output value and offer producers a new means of protection for their interest. This practice can benefit both the state and the people. It is using the method of commodity economy to solve the problem of commodity economy. The organized founding of a futures market in China will be an important way to coordinate the relation of regional interests. Through the form of futures, the interests of producing and marketing areas will be linked together on the basis of flexible and quick exchanges of equal value. If the experiment of hog commodity succeeds, it will provide valuable lessons for further expansion of futures trade

and find a new solution to problems in the production and market-oriented circulation of farm products.

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### Recommended Measures Against Inflation

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[Article by Yang Zhongwei [2799 0112 0251], Zhang Shuguang [1728 2562 0342], Wang Cheng [3769 6134] and Han Zheneng [7281 0455 5174] of the Economic Research Institute under the Chinese Academy of Social Sciences, March 1988: "Measures Against Inflation in China"—passages in boldface as published]

[Text] We discussed in the article titled "A Diagnosis of the Inflation in China" (JINGJI YANJIU No 4, 1988) methods for diagnosing inflation and estimating China's inflation rate in recent years. We now analyze the causes and mechanism for the formation of inflation in China, and put forward measures against it.

### I. Causes and Mechanism for the Formation of Inflation in China

The growth of inflation in China has reached a serious level in recent years. While it plants its root in the system, the emergence of such situation affects the implementation of policies, and brings about a deviation of direction in our reform strategy.

#### First, Background for the Formation of Inflation

The influence of traditional system on the current formation of inflation is not to be ignored. First of all, the long-standing policy of freezing prices acts like a dam in the long river of economic operation, blocking the channel of economic operation and accumulating an immense potential power. Once it loosens, inflation will become insurmountable like a burst dam. Second, to a large extent, China's economy is a welfare economy operated by subsidies. Consumption, production, loss, price, import-export subsidies and so on become the important conditions for normal economic operation, thereby forming a spiral development that subsidies promote more subsidies, and welfare promotes a wider extent of welfare. The consumption subsidies encourage consumption, check production, and waste resources. The loss in subsidies is actually a pure consumption and loss of society in terms of products and production resources. All these play the role of widening the gap between supply and demand, and promoting inflation. Third, there is only centralized planning but not a unified market under the traditional system. The direct planned control and planned distribution of social labor and production resources bring about numerous structural shortages and structural surpluses. Due to the lack of regulation by market mechanism, this kind of surplus cannot properly bring about its economic results, as

there is no free mobility and re-combination. This thus worsens the aggregate balance as well as the structural balance, and hinders the operation and development of China's economy.

In China's current economic operation, the transitional nature and major defects of the two-tier system play a decisive role, which is also a structural cause for the formation of inflation in recent years. First, there are two sets of operation rules and regulation mechanism in the two-tier system. They restrain and dispel each other so that signals generated therefrom are confusing and our instructions become ineffective. Under these circumstances, an economic subject will find no rules to rely on and consider the situation carefully before taking a further step, if not try the best effort to locate and exploit the loopholes in these two systems and rules. This thus brings about various acts not conforming to the rules and regulations, and the economic operation as a whole is in a state of chaos. Second, the overall manifestation of the two-tier system's transitional nature is that it is structurally unstable, which means policies are deprived of continuity and heredity. In return, this makes various economic subjects expect instability, or even cherish only immediate interests and neglect long-term development, which goes against our expectations through those policies. Third, the two-tier system not only maintains the disadvantages of the outdated system, but also affects and distorts the development of the new one. The traditional system is the one that strives for quantity expansion, in which the relations between economic growth and money supply are distorted and reversed. The present system still has not changed these relations, in respect of which it has just adopted a different approach. The planned expansion of economic growth formerly took place in a single subject. It gradually expanded to a number of them at the administrative level, thereby developing structural contradictions, forcing a continuous growth of the scale of loan granting, and bring about an endless supply of money.

#### **Second, Deviation of Direction in our Reform Strategy—Direct Cause of Inflation**

Essentially, the process of economic structural reform is the one of switching the mechanism formed by the close combination of interests distribution and development of wealth. Its purpose is to make each economic subject promote their own interests by actively taking part in the creation of national wealth. However, as reforms are theoretically regarded as purely a regulation of interests, the direction in our reform strategy stresses the distribution of centralized interests rather than the switch of mechanism. This thus intensifies the disadvantages of the two-tier system, further sharpen the conflicts between the two sets of rules and regulation approaches under it. Therefore, the distorted signals become more confused, thereby promoting and magnifying the inflation. First, the reform strategy highlights the regulation

of interests, makes the contradiction of national income distribution become apparent, and brings about inflation in both demand for investment and consumption.

The current analysis on the demand inflation mainly are conducted by taking the results of economic operation as their standpoint, that is, they hold that inflation is caused by the demand inflation in investment and consumption. Though this assertion is by no means groundless, it only uses a phenomenon to explain another phenomenon, rather than revealing the underlying structure of inflation. In order to clarify the causes and mechanism of inflation, we must proceed from the acts of economic subjects and its formation environment. Only thus can we grasp the main points. Under the traditional system, both enterprises and individuals are actually not an independent subject with invested interests. Only the government, particularly the central government, is the principal or even the sole decision-maker in terms of distribution of national income. In the wake of recent reforms, there has emerged diversified subjects with invested interests and an independent situation. Governments, departments, enterprises and individuals began participating in the formation and distribution of national income as an independent person. However, we proceed in our work by means of stimulation of interests, such as carrying out reforms separately by various sectors, allowing departments to undertake work on a contract basis, and decentralizing the decision-making power to enterprises; rather than changing the mechanism, which will create an environment for fair competition and allow various economic subjects to concentrate their efforts on the creation and formation of national income. This switches the focal point of various economic subjects onto the scramble of national income. Therefore, the present economic operation is basically marked by bargaining, and the phenomenon of expelling and contending with each other is a common economic activity.

From the viewpoint of an individual, reforms originally improved efficiency, widened individual differential income and gave awards to the advanced ones. Where there is neither a labor market nor a regulation of wage levels by the market, and in the social environment where the income difference is conspicuously widened, people compare only their wages and bonuses rather than their efficiency, thereby putting pressure on and pushing up wages and bonuses. The present conditions of operation by enterprises are the results of investment and decisions made by the state at an earlier stage. As prices are seriously distorted, the difference in the profitability of enterprises as well as their profit margin does not reflect their actual level of operation and labor results. This thus brings about the cause of the trouble with lateral comparison. An increase of wages and bonuses by profitable enterprises therefore starts the chain reaction of pushing up the wages and bonuses of the trade as a whole. In the process of bargaining and mutual comparison, the growth rate of wages and bonuses hence exceeds that of labor productivity. As



plans about free selection of jobs, as well as free mobility, are still on the drawing board, matters about the health, education and employment are basically still handled by enterprises, and the extent of granting welfare by the state reaches an excessive level. When the overall level of wages and bonuses is under control, welfare expenses become another channel for presenting bonuses in kind, which eventually promotes the demand inflation.

From the viewpoint of enterprises, the present reform of enterprises is strongly marked by the features of a representative system and contractual taxation. The imperfection of enterprises' decision-making structure usually brings about changes in their operational and structural conventions. Enterprises are concerned about short-term results as it is impossible for them to guarantee its development prospects and their expected return. Proceeding from their own interests, enterprises must first bargain with the government in order to obtain favorable conditions for their operations, such as a higher proportion of retained profits, more allocated materials at parity prices, more low-interest loans, repayment of loans before taxation, more subsidies for losses and so on. What they want is to take more in the social distribution of pure products. In addition, enterprises are checked by the mechanism of "cost increase," which is particular in a financially controlled economy and formed by prices. They can easily pass the burden onto others through pricing. Under the conditions where the interest rate of savings is lower than that of loans, enterprises also adopt the method of switching their capital (that is, they apply for loans from banks for their current production while using their working capital as investment in fixed assets or as welfare for staff and workers). They increase their base and proportion of distribution receivable in the next round by obtaining in advance an extra share from the national income of the following round.

From the viewpoint of local governments, the practice of carrying out the same work separately by various governments, and the proportion of tax delivery, the proportion of retained revenue, and the amount of fixed subsidies are periodically assessed by the central government. The proportion of retained revenue has always been under a "gentlemen's agreement." It is very difficult to clarify the scope of revenue from that of expenditures. The local governments can therefore bargain with the central government on these areas. They may also try every means to cut the amount of revenue payable to the central government. At the same time, they may apportion expenses to enterprises, so that they will receive as local revenue some of the income receivable by enterprises, while changing some of their local expenses as expenses of enterprises.

From the viewpoint of the central government, it combines the subject with vested interests with macroscopic readjustment and control. It is an undertaker of the distribution of income while contracting out contractual enterprises. When its expenditures exceed its revenue,

the central finance often adopts the following measures in order to redistribute the national income: (1) it borrow funds from the local governments but does not repay them; (2) it issues treasury bonds and urges enterprises and individuals to subscribe them by means of apportioning; (3) it indirectly levies taxes on all sectors by making overdrafts from banks. In fact, this is an approach of giving practical merits to the public through decentralization of power, and collecting them back by means of inflation. This thus affects the stability and continuity of our policies, undermining the prestige and effects of our current reform measures. Furthermore, the central government is still the prominent body responsible for the distribution. The expenses that it shoulders involve the interests of various sectors, and there is little room for cutting them back because most of them have an important bearing on people's livelihood and the national economy. Under the great pressure of sharing income by various economic subjects, the central government cannot help but adopt short-term measures for taking turns to alleviate the situation. For instance, it increases the wages of this group of workers this year, and will increase that of another group of workers next year. Consequently, the growth rate of wages is so great that we have never solved the irrational phenomenon in our distribution of income. The initiative of workers mobilized by such an increase is once again offset by a new kind of equalitarianism. If we increase the price of this group of products this year, and that of another group of products next year, we shall never put an end to the distortion of prices. Rather, the price level will rise to a level that the increase of prices encourages consumption while checking production. As a result, we shall face complaints from various areas and never achieve our expected goal. Therefore, we can see that under the rigid system of interests, there is little room for readjusting our policies. If we do not put an end to this system, it will be very difficult for us to achieve our goal regardless of any readjustment of the policies. On the basis of the above mentioned analysis, we have evaluated the relevant variables in connection with the acts of economic subjects; and generally take the increase of loans, (D), as a result of enterprises' acts, take financial deficit, (C), as a result of acts of the central government, take the foreign exchange surplus, (B), as a result of acts of the central and local governments, and take the monetary income of laborers, (W), as the acts of people. After conducting the regression analysis of them, as well as the increase of aggregate supply of currency (M1), we get the following result:

$M1 \text{ equals } \text{minus } 128.09 \text{ times } 0.50D \text{ plus } 0.77F \text{ plus } 2.71B \text{ plus}$

$(0.12) (0.28) (0.36) 0.72W (0.25)$

$R \text{ square equals } 0.99 \text{ DW equals } 2.85$

The source of the above data was the 1978 - 1986 statistics. As the sample of DW was quite small in scale for examination, it was difficult to determine whether it

was related to its own stage. It was, however, obvious that the degree of R square was very high. This confirms our conclusion that the contradictions in the distribution of national income, which is becoming apparent, brings about demand inflation. Our regression statistic analysis of the above variables for the period from 1953 to 1978 showed that the figure of R square during the period was 0.48, which also confirms the above conclusion.

The ultimate results of acts by the economic subjects bring about the demand for investment and consumption. Being the ultimate usage of the national income, these two component parts originally complement each other. Structurally, the proportion of these two reflects the balance between and selection of present consumption and long-term consumption by society. The mechanism and standard of this balance and selection vary in different systems. Under the traditional system, it is a planned balance and administrative control; whereas, under the conditions of market economy, it is checked by the mechanism of market interest rate and financial restraints. Under the present system, effects of the planned balance and administrative control have been greatly weakened because of the varied subjects with invested interests and changes in the economic flow. Moreover, the system of interest rate for checking the situation is yet to be formed, and the economic subjects pursue both the quickest maximum profits and the long-term maximum profits. Therefore, in addition to restraining the ultimate resources, the absence of complementary relations between the demand for consumption and that for investment strips away the proper relations of balance between investment and interest rate, between loans and interest rate, and between savings and interest rate. Between 1957 and 1978, the relative relations between the investment in fixed assets by society as a whole and the interest rate on loans was as low as 0.042 and the situation was not checked by interest rates. Though there was some improvement between 1978 and 1987, the relative coefficient was still very low, only 0.355. The figure was just 0.374 for the period between 1980 and 1987. Therefore, we can see that the interest rate on loans did not become an influential mechanism readjusting the scale and orientation of investment. Similarly, the interest rate did not affect the amount of loans granted for production. Between February 1980 and October 1987, there were positive "relative" relations between industrial loans and interest rates on loans, as well as between general loans and interest rates on loans. Their relative coefficient were 0.90 and 0.91 respectively. The flexibility of the two became immeasurable. This indicated that in terms of economics, there were no relative relations between loan amount and interest rate on loans. As loan granting was still subject to administrative decisions and the wishes of officials, it was no wonder that inflation took place.

During the formation of bi-inflation, there was no checking mechanism. Rather, the situation was marked by the practice and effects of mutual promotion. In connection with the increase of national income, a rapid increase of

wages, bonuses and other kinds of income brought about a very high growth rate of savings, which in turn were granted as loans and became a source of investment inflation, and brought about a new increase in income. This phenomenon may be called multiplication effects and acceleration theory of bi-inflation.

**Second, distortion of signals disrupt the distribution of resources and upset the structural balance, bringing about a shortage of effective supply.**

Economic development is a cycle of reproduction, in which the relations of cause and effect can be traced. In the distribution of national income, the formation of wishes concerning the interests of various economic subjects is influenced by the confused economic rules and the gloomy prospects caused by the change of system, as well as the distortion of price signals. This not only sharpens the contradictions in the distribution of national income, but also brings about an uneven allocation of resources. Therefore, a deviation between the aggregate supply of society and structure develops, thereby being a shortage of effective supply. This is another structural reason for having a serious inflation.

In macroeconomics, changes in supply are mainly realized through acts of investment (including the re-organization and transfer of key elements) by various economic subjects. If, under the traditional system, the orientation of plans determines the allocation of resources in various production departments, most of the investment (including the domestic loans, utilization of foreign capital, self-financing, and other investment) under the present two-tier system is influenced by the orientation of market, though it is still subject to political selection and administrative decision, except for the budgetary investment of the state, which accounts for about 15 percent of the total investment sum, and which is completely determined by the orientation of plans. As the distortion of current prices is quite serious, the effects of market orientation often bring about incorrect allocation of resources and structural readjustment.

First, prices are originally a kind of assessment made by society on resources in terms of scarcity. In China's present situation, however, the fewer the resources, the lower the prices; therefore, the more the wastage, and the wider the gap. For example, though China is in need of capital, its price—interest rate—is very low. Furthermore, the interest rate on deposits is higher than that on loans. Under the situation where the quantity expansion and budgetary restraints are weakened, various economic subjects, on the one hand, need an unsatisfiable amount of capital; and, on the other, capital is so easily available that it is wasted and not effectively utilized. Though the demand for energy resources and raw materials is very great, the price of coal, oil, electricity and timber is so low that any waste of these does not put a heavy burden on enterprises. Therefore, it was very difficult for enterprises to voluntarily practice conservation though the government repeatedly urged them to

increase their output by cutting their consumption. Facing this situation, the state not only increases the supply by putting more money into circulation, but also controls prices and checks demand through administration measures. However, the price control cannot check the demand. Instead, it checks the supply, and forms the vicious cycle of low prices—control—shortage.

Second, the transfer and substitution of resources often take place in an economic development, which is the direct cause of structural changes and economic growth. The transfer and substitution of resources take place in two forms: the first one is voluntary transfer and autonomous substitution; and the second one is compulsory transfer and compulsory substitution. As the price control under the conditions of two-tier system is a partial one rather than a comprehensive one, any control over excessively low-priced products will inevitably bring about a compulsory transfer of resources and a compulsory substitution of consumption. It is impossible for this kind of transfer and substitution to put a positive effect on the structural changes and economic development. For example, China's current grain price is not only too low but is also actually subject to control.

A protective reaction of these economic subjects is to transfer such resources as land, capital, and labor force to areas which are not subject to the control, and develop the production of products whose price is relatively high, such as pond fish, fruits, vegetable and town and township industries, thereby worsening the supply of grain as well as pigs and eggs.

Third, the present distortion of signals is not only reflected by the controlled prices but also by prices which are not subject to the control. As we adopt a low-pricing policy toward the price-controlled products, there is a wide gap between them and those of products which are open to the market, thereby developing a relatively irrational price. While raw materials are still subject to the low-pricing control, most of the prices of processing industries products are open to the market. To a very large extent, this exaggerates the rate of profit achieved by the processing industries, and gives a distorted signal for investment. Moreover, the current practice is that of carrying out the same work separately, the time on contracted operations is limited, and both local authorities and enterprises spend their capital on projects that can bring quick results. This is just the inherent mechanism of inflation in the processing industries in recent years, and an important reason that we cannot smoothly readjust the industrial structure.

To put it in a nutshell, the apparent contractions in the distribution of national income, and the irrational allocation of resources, caused by the deviation of direction in reform strategy, as well as the transitional nature and instability of the two-tier system, push the aggregate demand of society into a state of inflation while making it difficult to increase the effective aggregate supply of society on the medium and long-term basis, thereby

gradually widening the gap between the aggregate supply and aggregate demand. In 1978, the per capita difference between supply and demand was about 125 yuan, which was increased to about 455 in 1986. Between 1978 and 1986, the accumulative figure for the aggregate supply of society was about 3250 to 3750 billion yuan; whereas that for the aggregate demand of society was about 5400 billion yuan. This showed a difference of as much as 1650 to 2150 billion yuan. Of the figure, the consumption demand was about 2900 billion, and the investment demand was about 1900 yuan, respectively representing 77 to 89 percent and 51 to 58 percent of the aggregate supply. (Footnote 1) (Calculations are based on the relevant data published by the "China's Statistics Yearbook 1987". The aggregate demand includes the purchase of commodities by residents, the purchase of services, procurement by groups, working capital investment, net investment in fixed capital, exportation, procurement by enterprises using foreign capital and by foreigners residing in China. The aggregate supply refers to the sum of production contributing to the national income, importation and the outflow of capital after deduction by peasants' own consumption and elimination of pricing factors by the national income reduction index.)

## II. To Switch the Mechanism, Intensify Reforms, and Harness Inflation

To intensify reforms and stabilize the economy are the urgent tasks. Furthermore, they are inter-related and restrain each other. Our reform will not win the public support and will not last long if we do not check inflation and tackle this tough issue. Likewise, it will be difficult for us to tackle tough problems and realize a stable development if we do not eliminate through intensified reforms the structural causes for inflation. The operation of China's macroeconomy will still be affected by the old pattern of tightening—inflation—tightening. Therefore, we must take stopgap and radical measures for dealing with inflation. The principle of taking stopgap measures is to intensify reforms. The direction of intensified reforms should, however, no longer be the one of readjusting interests. Rather, it should be the one of switching to another mechanism, developing markets, formulating rules and regulations, and having a promising future. The aim of taking stopgap measures is to check the situation appropriately and to gradually eliminate the inflation.

**First, to stabilize the money supply, and to maintain a stable price of goods.** The recent money supply is plagued by an excessive growth and sharp fluctuations. It's better to regard the drop in 1985 as a sharp brake rather than soft landing. China lacks a long-term and steady goal for its monetary policy. It often handles the operation on a case by case basis, and it is an interrupted progress. We should realize that the work of harnessing inflation requires us to pay a price in addition to going through a process. Inflation does not emerge overnight, and it takes time to solve the issue. We paid a high price in this



respect when we managed this crisis by means of a sharp brake. In the present situation where the economy is overheated and inflation is serious, we should draw lesson from our experience in the previous two occasions of tightening. We should implement the strategy of cutting the monetary supply, and gradually eliminate within years the negative efforts on economic growth brought about by our acts of tightening. After the excessively issued money is absorbed and inflation is eliminated, we should formulate a goal for long-term steady growth of the monetary supply, maintain a coordinated development between the monetary supply and economic growth, and implement the strategy of stabilizing the monetary supply, so as to make the monetary supply become relatively scarce. Only thus can we maintain a stable monetary value, improve the microeconomic efficiency, get rid of the big pot of having an "endless supply" of money, and avoid the development of inflation and the crisis management of taking a sharp brake.

**Second, to turn financial deficit into credit, and to rationalize the relations between finance and banking.** Beginning in 1979 (except for 1985), we saw heavy financial deficit for eight successive years, totally more than 60 billion yuan, thereby becoming an unstable factor in our economic development. We need to increase the revenue while cutting expenditures in order to eliminate the deficit. To make up for the deficit, the finance of the state traditionally makes overdrafts from banks. An alternative option is to turn it into credit by issuing state bonds. The mechanism of the two are different, so are their results. In the former approach, we still do not solve the issue about the independence of banks, and the financial operations are irregular. Moreover, its results are the increase of monetary supply, devaluation of currency, and the promotion of inflation. The latter approach creates conditions for turning the central bank into an independent body and for stabilizing the monetary supply, eliminates structural obstacles, and leads the financial operations towards standardization. The issuance of state bonds can absorb currency, transfer the purchasing power, turn short-term funds into long-term capital, and help check the inflation and stabilize the economy. Therefore, we advocate changing the operation mode of the finance and banking, and the practice of turning deficit into credit. Meanwhile, we should improve the method of issuing state bonds, open the bond market, and allow its free circulation.

**Third, to change the distribution mechanism of financial investment and goods and materials, and to develop the futures market.** The present financial revenue and expenditures include two parts with different nature: The financial revenue includes all tax revenue from various kinds of enterprises, as well as profit delivered by state-owned enterprises. The financial expenditures include expenditures in connection with the administrative and supervisory activities of the government, as well as investment expenditures by owners of state-owned enterprises. These two types of revenue and those of expenditures are mixed up so that it is difficult to

distinguish the dual status and dual role of the state, and the separation of administrative power is mixed up with the separation of economic power. Being a subject with invested interests, any violation act by the government often brings about adverse influence on behavioral expectations and behavioral modes of other economic subjects, and undermines the credit and effectiveness of policies. This kind of confusion also covers the real cause for having financial deficit, so that the income derived from administrative undertakings and activities by the stratum with invested interests competes with the investment in key construction projects. Moreover, as the supervision of key construction projects is centralized by the central government, the target of distribution of, as well as competition for, interests is switched to the central level, which makes it further difficult for the market to develop. The fundamental way of solving this issue is to "separate the functions of the state, and separate profit delivery channels from the taxation one" (Footnote 2) (See "To Uphold the Proper Separation of Power, Remold the Setup of State Supervision" by the group for macroscopic management tasks of the economic research institute under the Chinese Academy of Social Sciences, JINGJI YANJIU, No. 6, 1987); and to change the operating mechanism, as well as the readjustment and control methods, of the economy. Under the present situation, we may, by following this train of thought, start by setting up funds for investment in key construction projects, and later turn the planned distribution in such industries as energy resources, transportation and raw materials into transactions in futures markets. The specific approach is: to determine, in accordance with the market demand, the orientation of investment and the specific project plans to be invested and constructed by investment companies. After these investment companies have completed the project designing and the selection of sites, they may invite public tenders for these products of planning as futures in a whole lot. Tenders of the futures market may be from the local government, various types of enterprises and their affiliates. But no individuals are allowed to speculate. This makes them take into full consideration the market demand as well as the interests of various areas, while basing the structural rationalization on the market operation. When the central government really begins carrying out the macroscopic supervision of, and formulating long-term development plans for, the macroeconomy, it will be in an objective position and will get rid of the work of readjusting disputes arising from interests and that of trivial matters.

**Fourth, to clarify and determine the ownership of revenue derived from contracts, and to standardize the supervision over distribution and utilization of revenue.** Today, China's economic structural reform has developed to such a stage that the contract system has become an established popular choice of enterprises in their reform. This indicates the practicability and rationality of the contract system. While confirming this development, we should realize that there are problems concerning the system.

Under the present circumstances, the basis of contracting is often based on the past situation because of confused understanding about the right of ownership and unclear status of assets. Furthermore, the practice of bargaining between the contracting subject and the subject contracting out the projects usually pushes down the contract target, so that the contracting person can easily obtain an excess income. As the rules of contracting are unclear, the following problems will emerge whenever the amount of excess income becomes too large: (1) The person contracting out the projects often changes the contracts, so that the expectations of various economic subjects become insecure.

(2) When a contracting unit accumulates a large sum of bonuses and deposits following the issuance of bonuses, it will adopt various "flexible" measures for giving workers subsidies and payment in kind in order to evade taxes on the bonuses, which becomes an important source of inflation in consumption demand. In order to tackle this problem, the state often adopts various remedial measures for pegging the loopholes. This thus strengthening the non-standardization supervision over the contract system.

In order to settle the contract system's problem of developing short-term acts by enterprises and the inflation in consumption funds, we should first clarify and determine the ownership of revenue by enterprises and contracting persons. Only thus can we stabilize the interest expectations of the contracting persons and the workers, and make them boost the production. Second, we must establish new rules and mechanism for the distribution and utilization of revenue, and lead them develop in a rational way. The balance after deducting the proper bonuses receivable by the contracting person and workers as provided in the state regulations, which is to be shared by the contracting person and the workers, should not be realized immediately. Instead, it should be used as an investment and only the profits derived therefrom can be shared by them, on which the state must levy the individual income tax. The advantages of this practice are: (1) The course of flow of revenue derived from contracts is changed so that the inflation in consumption demand is checked, investment is encouraged, and both the contracting person and workers are concerned about the long-term development of enterprises. This thus gives a new point for the development of contracting system, and helps it transit toward the system of share holding. (2) This standardizes the collection of individual income tax. The present target of individual income tax on income other than wages and bonuses is individual persons. Before the establishment of a perfect individual income tax collection system, the present measures are just valid in the form. It is therefore difficult to collect the tax, and it simply cannot play the role of readjusting the distribution of income. As the target of the income tax on profits derived from reinvestment with income obtained from contracts is enterprises and collectives, it is actually the delivery of taxes on behalf of workers. Therefore, the collection of individual income

tax is well-organized and ensured. By basing on this basis, this will help establish an individual income tax collection system with individuals as the target.

**Fifth, to develop circulation organizations for agricultural products, and open the price of agricultural products to the market on a regional basis.** Proceeding from supply, the present market structure of agricultural products is a full-scale competition market. Proceeding from demand, however, it is mainly a buyers' market of the state. In this market structure, the decision-making power of pricing is in the hands of buyers. It is difficult for us to either open it to the market or to rationalize it. It lacks a buffer organization between peasants and the state to coordinate the supply of agricultural products, which is marked by small-scale production, and the demand of cities, which is marked by large-scale industries. The solution to settle this contradiction is to properly grasp the work of establishing a circulation organization for agricultural products, as well as developing futures markets for agricultural products, in addition to clarifying the right of land ownership. The specific approach is: To establish, on the basis of volunteerism, various circulation organizations for agricultural products, which will gradually take over the state-run business about the contractual purchase of agricultural products and will take the risks of operation. These organizations may order agricultural products from peasants, and undertake futures transactions with enterprises engaging in the processing of agricultural products. We may develop futures markets and allow free transactions after this kind of circulation has become popular in major agricultural production areas. The state may provide certain support by setting up funds for agricultural products. The advantages of this practice are: First, we can stabilize the agricultural production, as well as reduce the influence on the agricultural chronic fluctuation and the overall price level. Second, we can promote the rural reforms, promote market development, and put an end to the situation of monopoly of agricultural products by the state, or the buyer, as well as get rid of that agricultural products are provided by the state. Third, we can establish buffer mechanism between the international agricultural market and the domestic one, so as to reduce the impact of supply-demand changes in the international market on our agricultural production. Fourth, we can cut the cost of transaction, improve the market's state of transparency, and reduce to a minimum level the activities of exploiting the situation of lacking quick access to information and rush for agricultural products. Fifth, we can develop the provision of services on this basis before, during and after the production, and establish a modernized system of agricultural production and operation.

**Sixth, to speed up the process of commercial production and monetization, and to ease the pressure of inflation.** China's present market scope is so narrow that quite a large part of its economic activities is still at the stage of barter economy: A large quantity of assets, commodities and labor is still not found in the market. Some take the

form of self-containing, some take that of barter trade, some are supplied (or subsidized) free of charge, some are subject to controls over free trade, and so forth. Furthermore, there is a large amount of savings deposits and cash in the hands of residents. By the end of 1987, the amount of savings deposits totaled 300 billion yuan, or one-third of China's total national income for that year, thereby forming a gigantic demand pressure. Under the circumstances where demand inflation is getting more serious, the overall price level will continue to rise even though we stop issuing new currency. This makes reforms more difficult and risky, and does not help develop a stable economic development. In accordance with the above mentioned analysis, monetization is a factor for undermining inflation. An accelerated process of commercial production and monetization can absorb the excessive currency in circulation, thereby easing the pressure of inflation. For this reason, we must speed up the pace of turning houses into commodities, diversify the financial assets, turn urban land into commodities on a trial basis, turn those state-owned small enterprises into private ones, and reduce the scope of subsidies (such as opening the prices of products, except for grain such as standard flour, corn noodle and rice, to market and allowing free transaction).

**Seventh, to turn underground economic markets into open ones, and dependent economies into independent ones.** At present, there are large underground and semi-underground economies, as well as dependent and semi-dependent economies, in China which is a common phenomenon in a centralized economy. Though this kind of economy helps expend the employment and compensate some weakness, it has become a major channel for violating laws and discipline, speculation, evading taxes, presenting payment in kind, increasing various unauthorized expenses, expanding the purchase power of groups and residents, and pushing up the demand inflation in consumption under the circumstances where the state-owned economic rights are unclear and the legal system is imperfect. This is also a step backward from the monetary economy to the barter economy, and poses great problems for our macroscopic supervision. Therefore, we must detach these underground and dependent economies from their original units, sever the economic links between them, and regard additional income distributed through this channel as additional bonuses and levy taxes on it.

**Ma Hong Discusses Real Estate Industry**  
*Beijing JIANZHU [BUILDING CONSTRUCTION] in Chinese No 5, 7 May 88 p 5*

[Article by Ma Hong: "The Real Estate Industry Should Be Vigorously Developed"]

[Text]

**The First Issue: The Real Estate Industry Is a Major Industry Worldwide, Especially in the Economically Advanced Nations.**

The real estate industry is a business which engages in the development and management of house and landed properties. Real estate is one of the most expensive of all commodities. The real estate industry is closely tied to the productivity and livelihood of the people, and plays a major role in the national economy, and is an important industry.

To develop the real estate industry, we must first acknowledge that real estate is a commodity. The commercialization of housing is a confirmation of this fact. Because housing is the product of labor, it has inherent value and use value, and is produced for the sake of economic exchange. It has the attributes of a commodity, and therefore it is a commodity. However, it is a peculiar commodity (for example, it is immovable.) The question is, is land also a commodity? A 1984 resolution on the restructuring of the economic system denied that land was a commodity, but it went on to say that the right to own land should be separated from the right to use land, that is to say, the right to use, as a right to do business, may be treated as a commodity, and that means it can be transferred with remunerations and traded back and forth. Generally speaking, land is a part of nature and does not have the attributes of a commodity. But developed land, for example, land for building houses, has the component of physical labor and is a product of investment, and therefore has the attributes of a commodity. Today, the central government has confirmed that enterprises may be bought and sold, that is, transferred with remunerations. This acknowledgement will be included in the enterprise law to be ratified by the Seventh National People's Congress. Enterprise property rights consist mainly of fixed assets, and real estate comprises the major share of those fixed assets. This means that not only housing but also landed properties are deemed commodities. Since practice has set the trend, theory should offer a clear scientific explanation.

The development of the real estate industry follows the development of the commodity economy. The history of economic development worldwide demonstrates that industrialization, modernization, and the accompanying urbanization generate a strong demand for land and buildings. Therefore, while real estate development is the product of economic development, it also directly affects the process of modernization. Today, the real estate industry is a fulcrum of economic prosperity. In many countries, real estate has long been a mainstay industry and plays a powerful role in the national economy.

The real estate industry should become, and in fact is entirely capable of becoming, a mainstay industry in China's economy.



Since the founding of the PRC, real estate has become an enormous material base in the country. Up to the end of 1985, total constructed area in all the cities and towns nationwide extended 4.676 billion square meters, 1.353 billion square meters of which are industrial buildings, 388 million square meters are commercial buildings, and another 388 million square meters are cultural and educational buildings, 196 million square meters are office buildings, 2.291 billion square meters are residential buildings, and 60 million square meters are buildings for other uses. Without considering the use value of the land (including land investments and differential earnings and others,) and based on an average construction cost of 150 yuan per square meter, the original cost of all buildings in the cities and towns nationwide amounts to more than 700 billion yuan, and the land is worth more than 700 billion yuan. Today, all the existing real estate in the cities and towns nationwide is worth at least 1.5 trillion yuan, a colossal wealth. Thus, real estate is one of China's richest industries.

The tremendous role real estate industry plays in our national economy is manifested in the following areas:

1. Construction areas and industrial buildings provided by the real estate industry are the material bases of urban economic activities.

2. The development of residential buildings provides essential living quarters for the workers, and is crucial for the reproduction of the labor force.

3. The development of urban building constructions (including industrial buildings and living quarters) is the driving force behind the development of the building materials industry, the construction industry, the iron and steel industries, the engineering industry, and other basic industries. Directly and indirectly, real estate development gives impetus to the above related industries.

4. The real estate industry can provide a huge source of revenue for the government. If the revenue is used primarily on urban development and on improving the urban investment and living environment, it can further contribute to urban prosperity and spur the development of the national economy. But so far we have not realized these benefits, because real estate has not been commercialized.

It should be specially pointed out that developing the real estate industry has significant effect on improving economic performance. In the cities, land is an important productive element and a valuable resource. In the past, because land-use was free of charge, land was misallocated and often misused. If we exact compensation for the use of land and develop the real estate industry and make use of the market mechanisms, we can promote the proper reallocation of land resources and obtain better economic returns.

### **The Second Issue: China's Economic Development and Structural Reforms Demand the Development of the Real Estate Industry.**

With the development of the socialist commodity economy, the commercialization of dwellings, and especially with the widespread promotion of the contracted management responsibility system, the development of the real estate industry has been put on the nation's development and reform agenda.

For more than 30 years, since the founding of the PRC, we have practised a low-rent urban housing supply system and a system of rent-free urban land use, and thus have made the development of the real estate industry impossible. This condition is the result of the traditional product economy, which is in direct conflict with the development of the socialist commodity economy. The old real estate management system has created all kinds of abuses; urban housing problems continue to plague society, and the conflicts are mounting. We are all familiar with these problems. The poor allocation of urban land has undermined the development of the economy and society. Today, especially, with the development of the planned commodity economy, many key productive elements have begun to comply with the laws of the commodity economy, and the conflicts have become even more acute.

The landed property system should be revamped so that the reform of the house and landed property systems can be complete. House properties owe their existence to the landed property, and landed properties realize their value through the house properties. Therefore house and landed properties are inseparable.

Reform of the urban landed property system is faced with the following tasks: one, we have to exact compensation for land use, and two, we should establish and nurture an urban real estate market. Some cities have already initiated pilot programs to exact compensation and charge a fee for urban land use. Shenzhen and Fuzhou have also initiated the auctioning of land-use rights. We are beginning to understand better the basic practice of charging a fee for land use and appropriate a portion of the receipt as land use tax. After further studies, we can implement the system in a planned and systematic way.

Exact compensation for urban land use is only the beginning of the reform of the urban real estate management system. The next step is to develop a market for the exchange of the urban land use rights. Only by so doing can the real estate management system get on the same track as the planned commodity economy.

Developing the real estate industry will give rise to a thriving real estate market, and because the real estate market is an organic part of the socialist market system,

developing the real estate industry will enrich and perfect the socialist market system and give full play to the positive role of the socialist market mechanisms.

Establishing a real estate market will have very positive effects on the proper use of urban land resources and the maintenance of their overall equilibrium in supply and demand.

First, the market helps real properties maintain their own equilibrium in supply and demand. Historically, Chinese cities and towns have always put housing under an in kind allocation policy in the product economy. On the one hand, this has overstimulated the people's demand, and on the other hand, because investments in housing only entail input but produce no output, they do not generate a beneficial cycle. Housing provision has become a financial burden for the state, and furthermore, it has become increasingly expensive to maintain the existing buildings which are deteriorating. With limited financial resource, it is impossible to start large scale construction of new housing, and therefore there is always an acute housing shortage. With a real estate market, we can rely on the law of economics to eliminate these conditions which are the product of the old system. Urban land should be treated the same way. Through the market for landed properties, the state should entrust the development of land-use rights to enterprises which have the best economic performance and are the most competitive. The supply and demand for urban land can be regulated by regulating the land use fees. Improper land use can be modified through market adjustments. Land should be put to its best use according to the principle of differential rent to get the highest economic return and social benefits. Here, we must emphasize the importance of integrating the market's regulatory mechanisms and the planned regulatory mechanisms, that is, urban land use should not be regulated entirely by market mechanisms; we must rely on urban planning and have a proper scientific urban land use plan. This is crucial in a planned commodity economy. We must promptly take care of this matter and enact laws to guarantee compliance.

Secondly, developing the real estate industry can modify the people's consumption mix. Because housing, a staple commodity, has never been a part of the consumption market, the nation's consumption mix has always been unbalanced. Housing cost takes up only 1 to 2 percent of the household income. In other nations, such as the U.S., France, Italy, Australia, and Turkey, housing usually takes up 25 to 30 percent of the household income. Because of the exceptionally low rent, renting is preferable to buying, and when people have money, they often spend it on other consumption goods, and this, first of all, increases the demand for food products, which aggravates the failure of the agricultural sector to meet the increasing demands. Secondly, it increases the demand for luxury goods and causes excessive consumption of certain products. By restructuring the housing system and developing the real estate industry, much of

the consumption funds can be diverted to housing, and this can ease the pressure on the market, and reduce the disparity between supply and demand.

If real estate is to become a part of the commodity economy and circulate in the market, we must pay attention to two elements. First of all, market mechanisms can promote the proper development of house and landed properties and facilitate overall economic growth. At the same time, however, we must not overlook the strong element of speculation in the market. Conditions abroad show that real estate speculation is prevalent, and governments of all nations are paying close attention and trying to control and prevent such activities. We must be prepared right from the start and try to minimize our loss.

Real estate prices directly affect the country's overall price level. Land-use prices directly affect production and construction, and housing prices affect public finance and the people's livelihood. Therefore, pricing policy must be handled with care. We should give play to the market's regulatory effects, but we must accommodate the country's present conditions.

### **The Third Issue: Development of the Real Estate Industry Amplifies the Functions of a City and Gives Play to Cities as Centers of Activities.**

Historically, Chinese cities have not fully amplified their functions. The emphases have always been on developing industrial production and constructions, and not enough attention has been paid to the tertiary industry, especially the municipal and public urban infrastructure, and, as a result, the investment climate and living conditions in the cities cannot satisfy the needs of economic development and the policy of opening up to the outside world. Underdeveloped urban infrastructure has become the major factor undermining urban economic developments.

Enlivening enterprises is the central link of the restructuring of the economic system. Among all the factors germane to the stimulation of enterprises, a city's external conditions are crucial. Inadequate supply of water and electricity, poor traffic system, and improper drainage system can hamper enterprise development. Today, because most urban infrastructure is overloaded, the cities' ability to fulfill certain functions has been weakened. We must pay serious attention to the situation. During reform, while we strive to enliven enterprises, we should also enliven the cities, energize them, and vigorously augment the construction of municipal and public infrastructure. This is a strategic problem. In the past, we have long ignored the problem and have suffered the consequences. Today, we must summarize our experience and make conscientious improvements.

Money is the main problem in augmenting urban municipal and public infrastructure construction. Requiring payment for land use is the best solution to this funds

problem. In fact, this method enables the government to get back its investment in urban land (infrastructure constructions) in the form of land-use fee through enterprises' use of urban land which generates differential earnings (profits), and the government in turn can spend the revenue on urban infrastructure constructions, and this means further land development and the realization of a beneficial cycle. Experiences in foreign countries are similar. Urban governments collect land taxes and other levies to be used to augment urban constructions and improve the investment environment. As enterprises develop, they generate even more tax revenue, and the cities have more money to spend on the construction of infrastructure and service facilities. In fact, the land is being further developed.

**The Fourth Issue: Urban Housing and Land Reform Must Complement the Restructuring of the Economic System, and All Parties Concerned Should Vigorously Support the Development of the Real Estate Industry.**

The restructuring of the country's economic system is faced with the critical problem of how to coordinate and complement the various reforms. The timing of each reform initiative and the pace of implementation require overall planning and organization. Every reform initiative requires its own set of appropriate external conditions.

Housing and landed property reforms require the right economic, administrative, and legal conditions, and the state and the cities must use economic, administrative, and legal means to promote these reforms and modify the economic relationship between the state and the localities, and among cities, enterprises, and individuals.

Housing and landed property reforms affect industry, commerce, public finance, banking, and taxation and other areas, and affect the personal benefits of the people. They have broad ramifications and are extremely sensitive processes. Therefore it is necessary to have the ardent support of all relevant parties. We also need widespread publicities so that the units and the people in the cities understand and support the reforms.

The state has already made specific plans for housing reform. As for landed property reform, certain external conditions are still under consideration. For example, if land use requires compensation, enterprises must pay a land-use fee, and from the point of public finance, this process requires unified planning and comprehensive considerations. This reform requires careful studies, overall planning, comprehensive preparation, and enthusiastic but steady implementation.

**The Fifth Issue: the Real Estate Industry Must Be Unrestrained but Properly Managed.**

If reform of the real estate industry is to succeed, it must be enlivened at the microeconomic level and properly managed at the macroeconomic level. Real estate must be managed by economic methods, not administrative

measures. This means that we should let the specialized enterprises (companies) rather than real estate management or other administrative organs manage this type of product. Real estate enterprises must be given ample right to make their own decisions so that they can operate with flexibility and maximize the economic return.

However, the government must tighten administrative control over this line of business. We must formulate scientific real estate regulations. On the one hand, the industry must be supervised closely to protect the state's properties. On the other hand, any appreciation in value (especially the differential rent) must be properly allocated to guarantee the state's share of income and also protect the interest of enterprises. We must take serious precaution against all speculative activities.

(This article is an excerpt from comrade Ma Hong's speech before the Real Estate Policy Symposium jointly convened by the State Council's Economic, Technological and Social Development Center and the State Commission for Restructuring Economic System on 7 March of this year.)

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## FINANCE, BANKING

### **Near, Mid-Term Financial Structural Reform**

40060338 Beijing ZHONGGUO JINGJI TIZHI GAIGE [CHINA ECONOMIC SYSTEM REFORM] in Chinese No 4, 23 Apr 88 pp 33-35

[Article by Jia Kang [6328 1660]: "Exploring the Near- and Mid-Term Financial Structural Reform Concepts"]

[Text] Financial structural reform is an important part of the grand scheme to restructure the economic system. Mandated by the long-term nature and the complexity of reform, not only do we have to define the long-term goal of financial structural reform, we must also work out an elaborate strategy and procedure to meet that goal. Here are a few exploratory suggestions on how to formulate a near- and mid-term financial structural reform program.

#### **I. Defining the Long-Term Goal**

A proper near- and mid-term financial structural reform program, above all, requires a clear definition of the long-term goal of financial reform. I feel that the general direction, or the general form of its objective, should be to establish a graded financial system based on a classified tax system.

Classified taxation, strictly speaking, means the designation of the various tax categories as either state or local taxes. Enterprises must pay state taxes to the central government, and also pay local taxes to the various levels of local government, as specified by law. Within this framework, the government at each level must plan its



spending according to its income, which is made up primarily of tax revenues, and be responsible for balancing its own budget. The goal is for "each level of government to have its share of administrative authority, its share of financial power, and its own budget."

The fundamental economic relationships between the state (the government) and enterprises, and between the central and local governments, converge and manifest themselves in the system of public finance. The main advantages of a graded financial system which is based on the classified tax system are, first, its ability to stabilize the allocation of financial power between the central and the local governments, and secondly, its ability to effectively and substantially neutralize the traditional "separatist" control over enterprises by all levels of government which treat enterprises as if they were their underlings. Under the classified tax system, enterprises no longer pay taxes to the primary level government designated by their immediate supervising organ (the "mother-in-law.") (and the revenues in turn are shared between the local and central governments.) Instead, different taxes will be handed to different levels of government. Consequently, the tendency of the various governments to interfere with or pamper "their own enterprises," and the existence of the "mother-daughter-in-law relationship" or the "father-and-son relationship" between the administrative organs and their subordinate enterprises, and the existence of "administrative ranks" among enterprises, will diminish, or disappear completely. As legal entities, enterprises will stand equal and be able to operate independently and engage in fair competition. Therefore, on the surface, the classified tax system cleanly separates the financial revenues of the state and local governments (most people have noticed this effect,) but more profoundly, the system changes the way the state (government) had always controlled enterprises directly as subordinate organs (most comrades have not realized this point.) Obviously, a graded financial system based on the classified tax system is consistent with the economic reform effort to rely more on indirect control and make the transition to an economic mode which "lets the state regulate the market and the market guide enterprise," and the system is in complete accord with the effort to enliven enterprises, which is the central link of the restructuring of the economic system.

## II. Recognize the Realities

The implementation of a fairly thorough classified tax system requires a complete set of proper conditions. In formulating a near- and mid-term financial reform program, we must clearly understand the constraints of realities and of the long-term objective.

The most basic conditions for implementing the classified tax system are:

1. The delineation of administrative authorities is the prerequisite to the delineation of financial power. The essence of separating the administrative authority of the

central government from that of the local government is in defining their investment rights. Limited by the "two-component economy" which characterizes the basic state of affairs in this country and our present stage of economic development, it is not possible to keep most local governments from investing in profit-oriented production and construction projects, and it is even harder to ask the central government to refrain from investing in those projects. This makes redundant administrative authorities inevitable.

2. To determine the financial power of the different levels of government by differentiating the tax categories, we need a fairly perfect and relatively stable tax system. At present, we are not making much progress with the pricing reform; many economic relationships are facing frequent adjustments; the tax system is constantly being modified and always being "patched up". Therefore, it is difficult to have stability and perfection any time soon. All hopes for greater improvements are in the timely implementation of joint tax and price reforms in the days to come.

3. To neutralize the "rigid separatist" control of enterprises as subordinate administrative organs, we need greater and more substantial progress in the reform of the political system and in the restructuring of the state economic management organs. The reform of the political system is still in the making, and meanwhile the promotion of the enterprise contract management responsibility system is vigorously under way. Together, they produce a side-effect which tends to stabilize and reinforce the "mother-daughter-in-law" relationship between the supervising organ and the enterprise. Therefore, it will take time to achieve any real reform in the economic management organs.

4. The success of indirect controls depends on the enterprises' ability to be responsible for their own profits and losses, and needs a fairly healthy market system as the intermediary. Reform in these two areas in turn sets off reforms in the systems of planning, pricing, finance, investment, and circulation of goods and material. None of these reforms can be accomplished overnight. Although the classified tax system may contribute significantly to the right kind of macroeconomic conditions for applying indirect controls, the system should not be implemented too far ahead of the other related reforms.

It seems that, for most parts of the country, conditions are not ripe for implementing the classified tax system within the near future. Apparently, we must find a proper transitional or intermediate financial mode between the present "eating in separate kitchens" system and our long-term goal of having a financial system based on the classified tax system. We have to make ample advance preparations for the classified tax system, and we must adopt a correct and gradual implementation procedure.

### III. Adopt a "Variety" of Transitional Programs

China is a vast country with extremely uneven regional development. Moreover, reform of the classified tax system is a very complicated and difficult process. We cannot expect good results by adopting only one set of methods or one form of transitional measures. In formulating a near- and mid-term financial reform program, we must emphasize "variety" and adopt different methods and transitional formats to suit measures to local conditions if the program is to have any real possibilities.

I feel that we must emphasize a two-tier differentiation. First, it is unlikely that the classified tax system can be implemented in most of China's provinces and autonomous regions in the near term, so we have to turn to other systems, such as various forms of financial guarantees. But in a few well-developed regions, the characteristics of the two-component economy are not evident, and the administrative authorities of the local governments are fairly well defined, and they are ready for the trial application of the classified tax system. Differentiating between readiness for the classified tax system and the non-classified tax system is "variety" at the first level. Secondly, whether the classified taxation system or the non-classified taxation system is adopted, we must not limit ourselves to only one method; we should select different formats to suit local conditions. This is "variety" at the second level.

This kind of "variety" should be based on "concrete analysis of concrete conditions" of the different regions:

1. We can experiment with the classified tax system in a few very well-developed regions (a couple of municipalities and several cities.) These regions have a well-developed commodity economy, and their enterprises have well-established lateral ties and are qualified to make their own investment decisions, and therefore the local governments can, in principle, transfer their investments from the profit-oriented projects to the construction of non-profit infrastructure. Even if we kept the present tax system basically intact and designate the present categories of circulation tax as central tax, the remaining income and local taxes are quite sufficient for funding local government spending. In addition, various types of taxes on resources (including tax on real estate income and other levies) can quickly be established and perfected in these regions to furnish steady income for the local governments. Many comrades in the localities worry that classified taxation will deprive the local governments of their steady source of revenues. They have overlooked the revenues which can be obtained by expanding the scope of taxation on resources; otherwise they would have drawn a much different conclusion. If there is excessive local revenues after implementing the classified tax system, we can consider the partial solution of guaranteeing a fixed amount, or an incremental amount for a fixed number of years, of the surplus revenue to the higher authority. Or, as an alternative, put

the shared revenues on reserve, the amount of which may vary according to changing conditions, and gradually break down and commingle the funds with other state and local taxes.

2. Choose 2 or 3 fairly well-developed provinces and implement an even more unusual tax classification program than the aforementioned pilot program. That is, after designating the various circulation taxes as state taxes and the remaining local levies as local taxes, we can commingle the income tax, taxes on resources, and other taxes, and share the revenues between the state and local governments. Or, take this portion and guarantee an incremental amount to the higher authority. We can consider a more thorough tax classification program later.

3. Most provinces in the moderately developed regions which normally hand over their revenues to the higher authority can implement a system which guarantees revenues and expenditures for a certain number of years. By promoting regional economic development and implementing more thorough reforms, they can become better prepared and be equipped with more suitable conditions for implementing the classified tax system in the future. The provinces may guarantee certain incremental revenues to the higher authority, the percentage may vary according to local conditions. Or, they can establish a fixed percentage of revenue-sharing, and set a different ratio for excess revenue over target resulting from economic growth, and by allowing the local governments to retain a higher percentage for the above-target revenues, they are encouraged to increase local income and promote local economic growth. Individual provinces and cities can also implement, in the next few years, the method of guaranteeing a fixed amount of revenues to the state. But this kind of fixed guarantees promote favoritism and dependence on special support, and should not be encouraged.

4. Depending on local conditions, we should reduce, by incremental amounts, the guaranteed subsidy for the few provinces in the moderately developed regions which are receiving general subsidies. Certain exceptional regions can consider the application of guaranteed fixed subsidies. The minority nationality regions and the remote and border provinces which adopt a similar system as in the minority nationality regions have just switched from a progressive subsidy to a fixed subsidy system, and in all considerations, should remain with that system for a few more years.

### IV. Grasp the Physical and Temporal Sequence

With regards to the above tentative plans, the near- and mid-term financial system consists of a spectrum which includes a relatively thorough classified tax system, a transitional classified tax system, different ways of passing on guaranteed revenues to the higher authority, and different forms of guaranteed expenditure subsidies. Individual designated region must carefully consider its

specific conditions, and make practical and realistic comparisons, before selecting a specific form among the different forms in the spectrum.

Furthermore, as far as timing is concerned, we must grasp the progressive sequence, that is, in a few years, as opportunity ripens, as we derive experience from the trial application of classified tax system, and as the economy of the regions with a non-classified tax system develops, and depending on local conditions, we can classify the tax categories more thoroughly in the regions already implementing that system, and allow some areas not yet implementing the classified tax system to adopt a transitional classified tax system. The conflict between the financial guarantee system and the classified tax system can be remedied. The key lies in having the right conditions before making the transition. In order to meet the long-term objective of the classified tax system, it is essential that we emphasize the seriousness and uniformity of tax laws in the regions under the financial guarantee system, and prevent enterprises under the contracted management responsibility system from adopting a "tax-included" format. We must formulate specific measures to ensure that enterprise debts are repaid with after-tax funds instead of pre-tax funds, and gradually create a regulated and standardized environment.

Historically we have implemented various forms of financial guarantee systems. The system of "eating in separate kitchens" practiced throughout the 1980's, strictly speaking, is also a form of guarantee system. Characteristically, the financial guarantee system encourages the local governments to take a more active part in increasing local revenues and planning local constructions and adopt a "separatist" local budget control format. But, by the same token, the system also produces a side effect which, while preserving the basic "rigid separatist" structure, reinforces the local governments' tendency to maintain the system of "ownership by the localities" and take matters into their own hands, and creates regional blockades and leads to duplicative constructions and other problems. Furthermore, when the local governments fail to deliver what they promised, the conflict is focused on funding by the central government, which increases the financial pressure on the central government. Therefore, although there is a time and a place for the financial guarantee system, it should not be a permanent fixture. For most parts of the country, if the near- and mid-term financial system is to meet the long-term goal of financial reform, the path to follow is to make the transition from the guarantee system to a system with some semblance of classified taxation, to an essentially classified tax system, and eventually to a thoroughly classified tax system. As we near our long-term goal, and as the economy develops and the reforms become more thorough, we can gradually make the classified tax system uniform, and adjust regional differences, and finally rely on the central government only for subsidies.

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## SMALL-SCALE ENTERPRISES

### Tight Credit, Restructuring of Township Enterprises

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[CHINA RURAL FINANCES] in Chinese  
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[Article by Fong Yimin [2075 3015 3046] of the Shandong Branch: "Discussing The Issues of Tight Credit And The Restructuring of Township Enterprises"]

[Text] Since the Third Plenum of the 11th Party Central Committee, with the promulgation of the general policy of reform and opening up to the outside world and the implementation of the rural economic policies, rural enterprises have developed rapidly and have become a force to be reckoned with. Take Shandong Province as an example, the output value of all township enterprises is estimated to have topped 43.4 billion yuan in 1987, which is 33 percent more than the previous year, and more than quadrupled the 1980 total output value. Township industries employ 8 million people, or 26 percent of the rural labor force; their products comprise 25 percent of all products in circulation. They deliver 10 percent of the nation's total export goods and supply 26 percent of the funds for supporting the agricultural sector, generating 1.3 billion yuan in state tax revenues. The impressive development of township enterprises plays a major role in the development of the commodity economy. However, the development of township enterprises was by no means trouble-free; it was faced with numerous internal and external constraints. From the point of credit fund supply, credit was tightened temporarily at the end of 1983, eased in 1984, and tightened again in 1985. Development has been fairly stable in 1986 and 1987. In the fourth quarter of 1987, however, the State Council handed down instructions to tighten finance and credit in an effort to stabilize the currency and product prices, and therefore the rural financial sector has tightened credit for township enterprises. People within the financial sector, and many local party and government leaders and comrades in enterprises, are concerned about the effects of the tight credit on the development of township enterprises which affects rural income and the tax revenues generated by increased output and in turn affects the local economic development. Such concern may be justified. In the past, tight credit had always produced adverse effects on the development of township enterprises. But the tightening of credit this time is different. Today, township enterprises are fairly well established, they have more funds of their own and more credit funds, and there is more room for capital turnover. Moreover, this time the primary goal is to control the total credit volume to facilitate structural adjustments rather than curtail economic expansion. Therefore, as long as we have a good plan and provide selective support and make reasonable adjustments, and



as long as we are practical and seek good economic returns and look for opportunities despite the tight credit situation, we can maintain the momentum of economic development.

#### **I. Support Only the Best, Maintain a Proper Growth Rate and Rate of Return**

The purpose of tightening credit is to facilitate the steady and healthy development of the economy, not to check its expansion, and even less to induce a full-scale recession. If we fail to tighten what should be tightened, the economy cannot develop in a steady and healthy way, and if we fail to develop what should be developed, we cannot balance supply and demand. Therefore, the tight policy is for the sake of development. Only by resolving the relationship between tight credit and economic development can we ascertain what elements we should tighten or support, and avoid sweeping measures. Only then can we support projects which deserve help and reject those which do not, and eventually achieve our developmental goals.

Ever since the financial sector took steps to support the policy to develop the commodity economy, we have repeatedly emphasized the need to be more discriminating and extend only selective support as the only way to keep up the growth rate and the economic performance. This is even more important under the tight credit policy. China's township enterprises have developed rapidly in recent years, and the credit volume has increased steadily. Take Shandong as an example, in 1987, the Agricultural Bank and the credit cooperatives have lent township enterprises 9.79 billion yuan, 2.495 billion yuan more than the year before, and at the end of the year, the loan balance stood at 7.05 billion yuan, 1.565 billion yuan more than the year before. This huge credit volume is scattered among many enterprises; some have put the money to good use while others have not. The difference is obvious, and we should support only the good enterprises and reject the bad ones. Based on last September's figures, Shandong's township enterprises have 2.17 billion yuan, or 38.4 percent of the total funds with norm, in the form of finished products, and 1.43 billion yuan in accounts receivable, which is 36 percent more than the previous year. These two items add up to 3.6 billion yuan, or half of the total loan balance. This clearly indicates that some products are not selling well and there is a huge surplus stock, the cost of which cannot be recovered even if sold. Capital turnover is very slow. These are overall figures; if we look at only those enterprises which are doing poorly, the situation is even worse. Therefore, under a tight credit situation, it is important that we be more discriminating and extend selective support. We must not take sweeping measures and control everything or decontrol everything. If we take a simplistic approach and control the total credit volume in one sweep without making a distinction between the good and the bad enterprises, we cannot guarantee funds for the deserving enterprises which have high capital turnover and can pay back more

of their loans, and instead we are helping enterprises which are poorly run and always have cash flow problems and cannot repay their debts. As a result, we are suppressing the progressive and protecting the backward enterprises. We must adopt a policy which is more discriminating, and guarantee funds for the good enterprises, refuse to fund the bad ones, limit new projects in order to sustain the productive capability of the existing projects which are doing well, put the limited funds in enterprises which are profitable, and help them increase production and get even better economic returns. In this way, we can maintain normal economic growth and performance, and guarantee higher output value and more tax revenues.

#### **II. Promote Structural Adjustment, Increase Enterprises' Ability To Compete**

Most of China's township enterprises have evolved from the old rural arts and crafts industry. Most of them are equipped with fairly primitive facilities and technologies, and their products are behind the times. Economic development requires a fairly balanced supply and demand, but at present, overall demand exceeds overall supply, and we must limit demand and increase supply. But we should not make a sweeping statement about the excess demand; we should analyze the specifics. Some products are overstocked and are not selling well and supply far exceeds demand while other products are in acute short supply. In a tight credit situation, if we want to speed up the development of township enterprises, we must expedite structural adjustment and increase the enterprises' ability to compete so that they can keep abreast of the ever changing market demands and keep the supply and demand balanced. An economy usually goes from a period of balance to a period of imbalance which requires some adjustments before it reaches a new balance and attains healthy and stable development. At last year's national planning conference, Comrade Zhao Ziyang said, "We must focus on the adjustment of the credit structure. Our main problem today lies in the poor credit structure." He also said, "In the area of fixed fund investment, we must curtail extrabudgetary investments. . . . As for current funds, we must cut back on funding for the production of goods and materials which are overstocked and products which are in abundant supply." Comrade Zhao Ziyang's speech clearly instructed the financial sector to focus on the adjustment of the credit structure so as to expedite the restructuring of the economy. This kind of adjustment must serve the needs of the national policy and satisfy market demands, which means cutting back on the production of over-abundant products and increase the production of goods in great demand. Different products may be in excess supply or in great demand, and we have to examine the local conditions. As far as Shandong is concerned, in recent years there are many new breweries, canneries, small textile mills, and cement factories. For some, the future looks dim even before they are ready to go into production. There seems to be an oversupply of some everyday manufactured goods, but there is also a shortage of

certain hot selling products such as small goods, stylish household goods, specialty foodstuff, fresh and sea water delicacies, and tourist products. And we must work harder on developing export goods which earn foreign exchange. Of course, some products are faced with not just production problems but also circulation problems which require appropriate adjustments.

When making structural adjustments, we should give play to local superior factors and take advantage of the credit funds and new technologies to produce goods which have superior market positions. Furthermore, we should acquire new equipment, advanced technologies, and modern management methods. In the past, township enterprises were stuck with equipment which were either obsolete or had been discarded by the large urban enterprises. In the future, we should equip township enterprises with modern facilities. We need better trained and better qualified leaders and staff and workers in township enterprises. Peasants should become peasant-entrepreneurs and technicians. We have to replace crude management techniques with scientific techniques. On the whole, we should continue the development of the labor-intensive type productions, but in the more advanced regions, we can shift to the more technology-intensive type productions. Most products should still target the domestic market but some goods should turn to the world market and join the international circuit. To get better economic returns, instead of relying on cheap material resources and labor, we should gain the competitive edge by relying more on the advanced technologies and on the prestige, speciality, and the superior quality of our products.

By controlling the credit volume we can adjust the credit structure to facilitate adjustments in the industrial structure. With a sound structure, more advanced technologies, and better management techniques, enterprises will become more energetic and can compete more vigorously, and then they will generate more income instead of less; they will promote economic growth rather than inhibit development; they will bring a solid rate of growth and economic return rather than hamper economic development and performance.

### III. Stem From Practicality, Coordinate the Development, Stabilize the Growth Rate

The development of township enterprises must follow the strategy formulated by the the 13th National Party Congress which emphasizes "high economic return, good quality, coordinated development, and steady growth." At last year's national planning conference, Comrade Zhao Ziyang pointed out that "the development of township enterprises must be well planned, and the rate of growth should be kept reasonable, preferably at 15 percent to no more than 20 percent a year." This clearly tells us that we must coordinate and stabilize the development so that we do not lose sight of reality and cause wild upswings and downswings which can be costly to society. Today, we can understand why local party and

government leaders are eager for faster development of township enterprises. We in the financial sector, however, must uphold the spirit of the tight credit policy, and seek progress amid the tight control. China is a vast country with extremely uneven economic development. Even within the same province there are sharp contrasts. Some local township enterprises have already reached considerable scale and standard while others are just starting out. Therefore, it is important that we suit measures to local conditions and provide separate guidance. Regardless of the speed of development, it is crucial that we do not lose sight of reality. We should take advantage of local material resources and superior factors. Regions which are developing slowly tend to be primarily agricultural, so we should develop the cultivations and breeding industries first and then shift to the processing industry. Those so equipped may develop mining and extraction industries. We can transform the economy which emphasizes agriculture over industry and commerce into an economy which gives top priority to commerce, then industry, and lastly, agriculture. But we must have the proper conditions first. While we want to emphasize village-run industries, we must not ignore the external and practical conditions and summarily give top priority to commerce before industry and agriculture, haste only makes waste. The fast developing regions already have a sound foundation; they should acquire more advanced technologies to transform their economy which puts commerce before industry and agriculture into an export-oriented economy and target the international market. As for the funds necessary for developing township enterprises, the emphasis is to enliven the existing available credit funds. We must attract more deposits which will enable us to extend more loans. But more importantly, we must help enterprises increase their accumulations, and allocate profits properly to replenish the enterprises' own funds rather than disperse and spend everything and have to rely on bank loans. One way to help township enterprises solve their fund problem is to help them revamp their business management and tap potential funds. During the first half of last year, Shandong's Agricultural Bank helped enterprises liquidate some assets and tap potential fund sources and activated 1.07 billion yuan. In addition, we must have a basic understanding about fund supply. Generally, most people equate bank loans with official support, and are happy when they get a loan, and they are upset with tightening of credit which they equate with non-support. In truth, while loans are a kind of support, tight credit promotes structural adjustment and expedites improvements in enterprise management, and is also a kind of support. Besides, the money saved by tightening credit is spent on the most deserving areas and helps to develop the local economy. Therefore, tight credit and bank loans are equally supportive. All parties concerned should support the financial sector's effort to comply with the State Council's directive to tighten credit. Amid the tight credit situation, we can still do a good job to stabilize the currency and product prices and promote healthy and stable economic development.

## FOREIGN TRADE, INVESTMENT

### Key Issues, Needs Related to Proposed Coastal Development Strategy

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[Article by Ji Chongwei [1323 1504 1218]: "Points To Be Considered in Implementing the Coastal Development Strategy"]

[Text] The economic development strategy for the coastal regions, proposed by Comrade Zhao Ziyang, has been discussed and decided on by the CPC Central Committee and the State Council. I would like to present some personal views on several important questions which call for attention in the implementation of this strategy.

#### I. The coastal development strategy should be closely linked with the national development strategy.

The coastal development strategy is an integral part of and subordinate to the overall national development strategy. Therefore, the coastal development strategy should be studied in proper perspective with the national development strategy.

As we all know, the national economic development strategy adopted by the 13th CPC National Congress is a strategy of coordinated development with emphasis on economic results. It calls for us to open wider to the outside world, enter the world economic arena more boldly, and adopt the correct policy on imports and exports and on the use of foreign funds.

What is the correct policy on imports and exports and on the use of foreign funds? The experience of various developing countries has shown that in the early period of development, the policy should be to promote production of import substitutes, but emphasis on import substitutes, if continued for too long, often leads to slow economic growth, poor economic returns, foreign exchange shortages, inability of enterprises and products to compete in the international market, and other problems. That's why after pursuing the policy of producing import substitutes for a period of time and laying a fairly good industrial foundation, Japan, Taiwan, and South Korea have all quickly switched to an export-oriented strategy and achieved great successes. Since China began opening to the outside world, it has paid more attention to export, but the emphasis remains basically on producing import substitutes. Technologies and equipment imported and joint ventures with foreign investments set up in the past few years are for the most part aimed at producing import substitutes for the less quality-demanding and more lucrative domestic markets. The spirit to compete in the international market is lacking. Up to 1987, three-fourths of foreign funds used were in

the form of loans, while direct investments made up less than one-fourth of the total. As a result, China's foreign debts have increased sharply in the past few years without bringing in much advanced technology. Therefore, Comrade Zhao Ziyang pointed out that the coastal regions must orient their economic development to the world market, continue to participate in international exchange and competition, develop labor-intensive and labor-and-technology-intensive industries, and encourage processing of imported materials or materials supplied by foreign firms and development of export-oriented agriculture. In the use of foreign funds, the emphasis is on attracting foreign investment, especially in the form of wholly owned foreign enterprises. He is right, and his suggestions embody the national economic strategy decided by the 13th CPC National Congress.

Because China, a big country with more than 1 billion people, still cannot produce enough to meet its tremendous domestic demands, and because Chinese goods are still not very competitive in the international market, it is not practicable for us to adopt a completely export-oriented strategy. Our strategy should be to promote production of both export goods and import substitutes, striving to make our export goods more competitive abroad while adjusting the import and export product mix in a timely and profitable way. However, because industrial development is uneven among different regions in China, each region should have its own step-by-step development strategy based on its location, characteristics, and advantages as well as the supply and demand situation in markets at home and abroad. For example, the coastal open areas and the textile and light industries should be predominantly export-oriented and play a supplementary role in producing import substitutes. The central and western regions and the metallurgical, chemical, machinery, and electronics industries should make meeting domestic demands and producing import substitutes their primary task, and play a supplementary role in export production.

We should see that the so-called import substitutes and export goods are not two opposites, but are closely linked and can be used in place of one another. Many products are at first substitutes for imports. When their quality is up to international standards, and cost reduced to a competitive level, they should be actively marketed abroad. This is the way the iron and steel, automobile, electronics, and other industries have developed in Japan and South Korea. Many of our products, like ships, household electrical appliances, etc., have also developed, or are developing, from import substitutes to exports. We should also see that by efficient production of import substitutes, we can not only save foreign exchange but raise our own technological and management standards and enhance our capacity for self-reliance. Production of import substitutes can contribute as much to the national economy as exports. Therefore, while stressing the foreign-exchange-earning role of exports, we should not ignore or belittle the importance



of import substitutes. The state should encourage, support, and give preferential treatment to new products, materials, and equipment produced as substitutes for imports in financing, investment, taxes, and material supplies. With regard to the raw and semifinished materials, components, and equipment, which are now imported in large quantities, plans should be made to increase their production in China step by step.

## **II. China urgently needs a well-guided plan for the development of strategic export industries and products.**

I think that in carrying out the coastal development strategy, we should conscientiously follow the policy of "moving into the international market in a well-guided, planned, and systematic way."

In international usage, the term export-oriented economy generally refers to economic growth propelled by exports. For this purpose, it is necessary to use foreign funds and import technologies to improve the production structure and raise the technological and managerial standards and competitiveness in the international market. This is the most important material foundation for expanding exports.

Postwar Japan, South Korea, Singapore, and Taiwan have all, with a strong sense of international competition, set clearly defined goals and formulated correct industrial and import-export policies. In every phase of development, they have selected a few strategic industries to play a decisive role in propelling the economy forward, based on international market demands and their own industrial conditions, and invested their limited funds and foreign exchange in these strategic industries to rationalize the production structure, technological structure, and import and export product mix. In this way, they have increased the strategic industries' competitiveness abroad, improved the production structure, and expanded exports. Since China began opening to the outside world, there has been no clearly defined industrial and import policies. On the use of foreign funds and importing technologies, there is no guiding principle, overall plan, or appropriate economic and technological policies to give priority to the strategic industries. With no overall guidance, each locality, department, and enterprise goes its own way, scattering resources and wasting precious foreign exchange and funds on overlapping construction projects and duplicate imports, making it impossible to develop certain industries producing popular items which can serve as a driving force while bringing good economic returns. On many occasions, blind and excessive imports of foreign products have even dealt serious blows at domestic industries. China's automobile industry, which remains one of the world's most backward today, should have taught us a serious lesson. On exports, owing to our lack of research and forecast on world market supply and demand, export producers cannot obtain timely and accurate information and are affected by price distortions. When demands are high in the international market, purchase

prices at home rise sharply, and producers rush into blind expansion. When supply exceeds demand and stocks pile up, prices plummet, and production shrivels. The lessons of the repeated rises and falls in the production of agricultural and sideline products such as rabbit hair, pearls, and ramie are particularly profound. Recently, induced by increasing demands for surgical gloves and condoms abroad, hundreds of latex production lines were installed in various places. It clearly tells us that relying solely on market regulation without planned guidance, it is hard to avoid blindness in investment and production. Judging by the international environment at present and into the 1990's, future international trade development is not promising. It is estimated that world trade will grow at an annual rate of just about 3 percent, and that the markets for primary products and manufactured goods in general will reach the saturation point. Competition will be keen, and protectionism and non-tariff barriers will get tougher. We want to import raw and semifinished materials and export finished products in a big way, but it will not be easy to get into the crowded international market and consolidate and expand our position. We must choose a course toward a strategic breakthrough, organize trade, industrial, and agricultural enterprises in the whole country in a planned and systematic way, fight a series of hard battles, and capture one position after another in the international trade war.

What industries should play the key role in expanding exports? China has a large population and labor force, but a low per capita share of material resources, and is very uneven in the development and structure of industry and agriculture. In view of these characteristics, I think that we should adopt a progressively stepped development strategy as described in the following.

1. We should devote major efforts to developing labor-intensive industries. However, because of the limited international market for this kind of product, slow-growing demand, serious protectionist and non-tariff barriers, and fierce competition against us by many developing countries, we should not continue to focus on ordinary processed goods requiring simple labor, but should turn to products which are knowledge- and technology-intensive as well as labor-intensive and are in greater demand. For example, products like ceramics, clothes, shoes, toys, and artistic handicraft items can no longer meet the higher consumer demands in the world market without the introduction of new technologies, materials, processes, and designs. From now on, we should also pay special attention to developing intellect- and labor-intensive products. For example, there is now a labor shortage for making software in the developed countries, and we can train large numbers of senior middle school students in cities to develop a software industry and expand software exports.

2. We should continue to develop exports of light industrial, food, textile, chemical, pharmaceutical, building material, and other traditional products, not in greater

quantities, but in diverse varieties and markets. Efforts should be made to improve product quality, packaging, grade, and unit foreign exchange earning power.

3. Major support should be given to export of machinery and electrical products. Machinery and electrical products have a large world market. China's machinery and electrical industries are fairly well developed and have great production potentials, but exports are negligible. For the near future, efforts should concentrate on increasing exports of machinery and electrical products which require a greater amount of processing labor such as household electrical appliances, lighting equipment, washing machines, bicycles, timepieces, auto and other parts and accessories, hand tools, hardware, fasteners, cast and forged items, bearings, electric wires and cables, ships and marine equipment, agricultural machines, diesel engines, electric motors, etc. At the same time, a foundation should be laid for capital- and technology-intensive products such as motorcycles, small and medium-sized civil aircraft, precision machine tools, power-generating equipment, complete sets of large equipment, etc., which are goods for the second-phase of export expansion. Products should be upgraded step by step—from low-grade to middle- and high-grade products, and from parts and accessories to complete units of manufactured goods—to add to their value.

I would like to suggest a principle for the development of the machinery and electrical processing and assembling industries. The production structure and export product mix of Japan, Taiwan, and South Korea have all gone through three phases of development to reach their present high levels. In the first phase, the emphasis was on textile, food, and other light industries; in the second phase, the emphasis was on metallurgical, chemical, and other basic materials industries; and in the third phase the emphasis is on the machinery and electronics processing and assembling industries. And the development of the processing and assembling industries (motor vehicles, television sets, VCR's, for example) has led to the rapid growth of per capita GNP. Therefore, we must pay serious attention to developing the machinery and electronics processing and assembling industries which can give a powerful impetus to national economic development as a whole. One development method is to start with the production of parts and components and simultaneously develop the capacity to process and assemble the end products. This is basically the way followed by Japan. Another way is to start with the processing and assembling of the end products, importing the needed parts and components, and then gradually achieve the goal of producing most of the parts and components at home. This is the way followed by Taiwan and South Korea. It is easy to get started and develop quickly this way. The drawbacks are greater dependence on imports and lower added values. Before opening to the outside world, China followed the first way. After its opening, it has followed the second way in developing the electronics industry and in joint ventures in automobile manufacturing. It appears that both ways have advantages as well

as disadvantages. Based on the present conditions in China—abundance in labor force, lack of raw and semifinished materials and of coordination and cooperation in industrial production, and low manufacturing and technological standards—I think what we need is a combination of the two ways, to make use of the international division of labor and international exchange in a flexible way and overcome our shortcomings by learning from others. The development of the processing and assembling industries, importing raw and semifinished materials and exporting finished products, including processing for foreign firms with materials supplied by them, is suited to China's present conditions and should be encouraged. A part of the products can be used as import substitutes to meet domestic demands, which will be cheaper than importing finished products. Of course, our goal is to eventually produce most of the raw and semifinished materials and parts and components at home, but it is a goal that can only be achieved step by step. We should not set the goal too high and try to accomplish it in a hurry as that is being unrealistic. Nor should we insist that 100 percent of the raw and semifinished materials and parts and components be produced at home, for that will only lead us back to the beaten track of self-imposed isolation.

4. We should speed up the development of high-tech industries. China has a fairly large number of outstanding scientists and technicians, rich intellectual resources, and a good research, development, and manufacturing foundation. On the whole, our strength and potential in these respects are far above the "four small dragons." The problem is, owing to the fetters of the system and the irrational distribution of essential productive factors, this potential has not been brought into full play. From now on, we must strive to closely link scientific research with commodity production. Particularly in the fields of information, optical communications, aeronautics and astronautics, bioengineering, and superconductor and semiconductor materials, we should train our own scientists to tackle key problems, assimilate the developed countries' high-tech research results, and develop export-oriented high-tech industries step by step. This will be a new force to earn foreign exchange through exports for our country in the 1990's and the next century.

In short, we must not only develop labor-intensive products to be exported in large quantities now, but pay attention to technology- and knowledge-intensive products which will be in great demand in the future. After we have decided on the strategic export industries and major export products, we must concentrate our forces to develop them in a planned and systematic way with proper division of labor and cooperation and coordination. In order to avoid repeating the mistakes we made in the past, when we rushed into action and started developing new industries blindly, resulting in overlapping and duplicate construction projects, overstocking, and waste, it is necessary to formulate a middle- and long-term development plan for the key industries and products, to be worked out from the top to the bottom and

involving every level in between. The plan should cover such major production, supply, and marketing links as domestic production, sources of raw and semifinished materials, and foreign markets. It should also be closely linked with plans on raising and using funds from domestic and foreign sources and plans on scientific research and technological development at home. Measures should be adopted to guarantee the plan's implementation. This is a complex systems engineering project and can be accomplished only by concerted efforts of all departments concerned. It is suggested that the plan be drawn up by the State Planning Commission with the participation of the Ministry of Foreign Economic Relations and Trade, the various industrial ministries, the Ministry of Agriculture, Animal Husbandry, and Fishery, the Ministry of Forestry, various trade associations, export chambers, the economic planning departments and import-export companies of the coastal provinces and cities, and conglomerates of large industrial enterprises. It will be a guidance plan, and its implementation will rely mainly on the active participation of enterprises, local authorities, and other departments with the help of the state through industrial policies and various economic means.

**III. It is necessary to properly handle the relationship between the coastal regions and the interior and between domestic trade and international trade.**

In his report to the 13th CPC National Congress, Comrade Zhao Ziyang pointed out: "So far as the geographical distribution of industrial development is concerned, we should make sure that the east coast region, where the economy is comparatively developed, plays its important role. At the same time, we should gradually accelerate the development of the central and western regions of the country, so that the different regions can take advantage of their respective strong points and, by opening up to each other and conducting exchange on an equal basis, develop a rational regional division of labor and regional economic structure." He added: "It is necessary to consolidate and develop the pattern of opening to the outside world that has begun to take shape, with the open policy extending progressively from the special economic zones to coastal cities, then to coastal economic regions, and finally to interior areas. With the overall interests of the national economy in mind, we should draw up a correct development plan for all these zones, cities, and regions. They should focus on development of the export-oriented economy and expand their horizontal economic ties with the interior areas, so as to serve more effectively as a base for implementing the open policy and as a window open to the outside world." Comrade Zhao Ziyang said: "If China's coastal regions...can really do well and find a way out in the international market and really switch to the direction of an export-oriented economy, then not only will the economy of the coastal regions develop faster and to a higher level, but it is bound to give a powerful impetus to the development of the central and western regions." For

this reason, he proposed the policy for the processing industries in the coastal regions to "import raw and semifinished materials and export finished products in a big way."

Some comrades like the orientation of "importing raw and semifinished materials and export finished products in a big way," but are not sure it can really work. Comrades of the coastal regions worry that the raw and semifinished materials, hitherto supplied by the interior regions, will no longer be available because the interior regions are going to develop their own processing industries; that it may be impossible to buy all the raw and semifinished materials from the international market; and that even if they can be bought from the international market, their prices will be too high to be used for processing and re-export. Still other comrades feel that the international market, with its limited capacity, will be very sensitive to the impact of large-scale imports or exports by China's coastal regions, which have a large population and great processing capacities. Moreover, we do not have a coordinating mechanism to enable our foreign trade units in different places to have a unified approach to trade relations with foreign countries. As a result, they are competing against each other in importing and exporting and may create chaos in markets and prices at home and abroad. This can cause the loss of the advantages we have and make it impossible for us to expand import or export.

I think it is understandable for comrades to have worries of one kind or another. We should prevent these problems from occurring. I personally feel that "importing raw and semifinished materials and exporting finished goods in a big way" is the direction for the processing industries in the coastal regions to follow, but the scale of imports and exports should be increased step by step according to subjective and objective conditions and cannot be rushed. At present, there is a problem which merits attention. Some places, which used to supply raw and semifinished materials to industries in the coastal regions, are now trying to develop their own processing industries and have stopped supplying the coastal industries, saying that the coastal industries should "import raw and semifinished materials and export finished products." Some interior areas, which used to supply primary products (such as yarn and cloth) to the coastal regions to be intensively processed for export, are now exporting on their own and no longer supply the coastal regions. This inevitably will cause the existing coastal plants to stop production for lack of material and their exports to sag, while the interior regions invest money to expand production capacity. The result will be lower quality and less intensively processed export products, and reduced foreign exchange earnings of the country as a whole. On the other hand, some hot-selling commodities, produced by the coastal regions to meet demands of interior regions, and commodities produced in cooperation with interior regions are now exported and no longer available to the interior regions. All this can weaken or hurt the original economic relations between the coastal



and interior regions and obstruct domestic circulation. China's participation in the great international circle must be based on unimpeded domestic circulation. Domestic and international circulations should be interlocked and overlapping like the "double line" trademark. The coastal regions are our connection to the great international circle. Without economic exchange with the interior, the coastal regions will decline due to malnutrition and inadequate blood supply. The economy of the coastal regions, with a population equal to Japan and the "four small dragons" combined, cannot be sustained by the great international circle alone.

How can the export-oriented economy of the coastal regions develop healthily and stimulate the development of the central and western regions and the entire national economy as well? It requires the government at all levels and the people of the whole country to correctly understand and handle the relationship between the coastal and interior regions and between domestic and international circulations. There should be a division of labor as well as close cooperation between the coastal and interior regions, and their lateral ties must be strengthened on the basis of equality and mutual benefit. The open coastal cities, especially the large port cities, should energetically serve the interior, providing the latter with trade and other information, marketing channels, storage and transport facilities, imported technologies, training, and so forth. Some labor-intensive industries or primary products should be spread to the interior. To the extent possible, exportable goods should be exported, and raw and semifinished materials in short supply at home should be imported. In the interior, efforts should be made to develop the commodity economy, and no regional barrier should be allowed to form. Raw materials supplied to the coastal regions under existing cooperation arrangements should be continued. The interior should not try to develop intensive-processing industries before conditions are ripe. The central government departments concerned should do a good job of macroeconomic planning and coordination between the coastal and interior regions according to the principle of coordinating all the activities of the nation like pieces in a chess game, taking historical economic ties into consideration and following the objective development trend. This planning and coordination is imperative during the coastal regions' transition to an export-oriented economy to mitigate contradictions and avoid many unnecessary conflicts and losses.

The following are two important organizational measures to strengthen economic cooperation between the coastal and interior regions, promote the integration of production with marketing, and enable the production enterprises to join forces in the international market. The first is to set up export-oriented enterprise associations led by backbone enterprises or manufacturers of brand-name products, which will gradually expand from regional to interregional and intertrade associations and become economic entities combining industrial, trade, and technological operations and with the power to deal

directly with foreign firms. The advantage of this type of association is that they can get all related enterprises in the coastal and interior regions organized to put production on a basis of division of labor and cooperation among specialized departments, achieve the efficiency of reasonably large-scale production, improve quality, and reduce cost. It can be an association of science and technology with production, to integrate the introduction, assimilation, updating, and transfer of imported technologies and help enterprises carry out technological innovations and develop new products. It can be an association of importers and exporters to regulate their imports and exports and assume responsibility for their own profits and losses. It can be an extension of contacts with technological and economic organizations abroad to collect international information, expand foreign markets, and participate in international cooperation and division of labor. It can also be investment in enterprises set up abroad to gain technology, raw and semifinished materials, and markets and stimulate exports of China's raw materials, semifinished products, labor services, technologies, equipment, and so forth. This type of organization, like a "large formation in joint operations," can bring the coastal and interior regions together in close economic cooperation and merge them into an organic whole. It will greatly increase our competitiveness abroad, and should be developed into the main force in the export-oriented economy of the coastal regions. The second measure is to strengthen the management, planning, coordination, and services for different trades through the relevant industrial departments of the central government, the trade associations, export chambers, and other organizations. The light, textile, electronics, and machinery industries and some provinces and cities have achieved some successes in industrial planning, site selection, specialization and cooperation, setting quality standards and tests, improving quality, training, and other areas. It is suggested that the departments concerned actively sum up and popularize the experiences.

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**Zhou Xiaochuan on Prerequisites for  
Export-Oriented Coastal Development**  
40060414 Chongqing GAIGE [REFORM] in Chinese  
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[Article by Zhou Xiaochuan [0719 1420 1557]: "Reform Holds the Key to the Success of the Export-Oriented Development Strategy"]

[Text] Abstract: The new coastal development strategy is to "participate more in international specialization and work hard to shift to a more export-oriented economy." Theoretically, it further rejects the notion that the function of foreign trade is to "regulate surpluses and shortages" and affirms the theory of comparative advantage, the law of shifting comparative advantage, and the superiority of China's decision in favor of export-oriented development. The key to the new strategy is reform. If we

are to accelerate the pace of foreign trade reform, we must delegate managerial power to foreign trade enterprises and hold them accountable for their own profits and losses, create an environment in which exports and imports flow smoothly, and allow foreign businessmen to manage Chinese enterprises in accordance with international practices. The new strategy poses a series of questions for economists and policy-making departments that have yet to be answered. For instance, what is the right mix of international experience and Chinese characteristics? How will excessive import controls affect the export-oriented strategy? What is the appropriate way to bring about fair competition? What objective economic policies benefit both reform and development?

### 1. The Understanding of Certain Notions About the New Strategy

On several occasions since November 1987, Comrade Zhao Ziyang has put forward important ideas on China's economic development strategy. Although he focuses on coastal development, his remarks are profound and wide-ranging and touch upon the entire national economy. The call for a coastal strategy has elevated China's state policy of economic development to a new high.

The new strategy is couched in figurative and catchy slogan-like phrases. Among the most quoted are "import and export on a large scale," "putting both ends on the world market," "export-oriented economy," "developing labor-intensive industries," and "the great circle." Since this article proposes to discuss the new strategy from the perspective of economics and policy science, we must begin by describing these concepts in the relatively rigorous language of economics and policy science before we can proceed with our analysis. Also, the new strategy has been variously understood and interpreted. Thus another aim of this article is to provide an interpretation of the new strategy.

In Chinese, the adjective "large" has several seemingly similar yet different meanings. For instance, it may mean "a majority" and even "complete." It may also mean "more" or "striving for a higher percentage." In defining "importing and exporting on a large scale" and "the great circle," I am inclined toward the latter meaning. From the perspective of economics, therefore, the new strategy may be defined as follows: "participate more in international specialization and strive to achieve a more export-oriented economy." That is, the new strategy does not necessarily require that we increase exports and imports to such and such a percentage of the gross national product. Nor is coastal industry required to obtain such and such a percentage of its inputs from and sell such and such a percentage of its output to the international market outside China. Instead of being set artificially, the percentages in the final analysis must emerge naturally on the two markets in accordance with the principle of the maximization of economic benefits

and mature gradually under policy guidance. A resolution of the 3d Plenum of the 12th CPC Central Committee in 1984 said, "Utilize two kinds of resources—international and domestic—and open up two markets—international and domestic." While the two proposals have similar theoretical implications, the 1984 resolution was not elevated to the level of a development strategy. Nor were the necessary institutional and policy conditions in place. Thus, the new strategy is a refinement of the 1984 proposition.

To some, the above mentioned call for "participating more in international specialization and striving to achieve a more export-oriented economy" may not sound exciting or radical enough. From the economic perspective, though, it is a radical piece of reform whose realization will not be easy. While we began advocating the "open policy" and "coastal export-oriented development" some time back, the Chinese economy is far from being an open economy and we have only taken the first step toward shifting our development strategy. These days the international economic community commonly defines an "export-oriented economy" as one linking the domestic and international markets and giving export and import substitution basically equal policy treatment, the so-called "neutral policy." China has emphasized time and time again in recent years the need to encourage exports and formulated quite a few policies. Because of import restrictions and domestic inflation, both of which result in discrimination against exports, however, the Chinese economy at the moment remains largely domestically-oriented. A recent World Bank report divides national development strategies into four types—firmly export-oriented, generally export-oriented, generally domestically-oriented, and firmly domestically oriented—and still classifies China as a generally domestically-oriented economy. This article contends that in view of its existing economic system and the current state of its reform, China still has a long way to go in its march toward export orientation and in its effort to remove discrimination against exports. Thus, in academic terms, it is both possible and appropriate to call for a shift "toward a more export-oriented economy."

Comrade Zhao Ziyang has formally called on us to participate in international competition and exchange actively and repeatedly mentioned capitalizing fully on China's advantages in international competition, particularly its clear edge resulting from changes in currency exchange rates. In the language of economics, this is a recognition of the existence of comparative advantage and of changes in comparative advantage, which can serve as a springboard to more active participation in international specialization. In the past, there was a prejudice, born of ideology, against international specialization and people avoided talking about it. In economic terms, however, what we have been discussing above in relation to the new strategy is in effect international specialization. The present system in China, though,

does not fully equip us to take part in international specialization. Thus this article stresses increased participation in international specialization through reform.

There are two ways to expand imports and exports. One method works through the plan. As the plan calls for more exports, we earn more foreign exchange, and with more foreign exchange, we can increase our imports, thereby "importing and exporting on a large scale." In the other method, we mainly rely on market regulation and correct economic policies to make the microeconomy import and export on its own. The press does not specify the mechanisms which China must adopt to develop an export-oriented economy, but judging from the general thrust of economic structural reform and the principle of foreign trade reform—"make enterprises responsible for their own profits and losses, deregulate management, integrate industry with trade, and implement an agent system," it seems we should opt for the latter approach. Recognizing the fact that per capita consumption of certain natural resources is quite low in China, we should make this change—more participation in the international market—part and parcel of overall economic reform, including the effort to build up, and utilize market mechanisms, and the development of a market orientation. We should integrate the international with the domestic markets, instead of stressing one at the expense of the other. Accordingly, even as the coastal industry looks more and more outward for production inputs and markets (which is what "putting both ends on the world market" means,) it should not divorce itself or shy away from the domestic market. In other words, if domestic commodity circulation cannot develop healthily, neither can the "great international circle."

## 2. New Progress of the Development Strategy and Its Theoretical Significance

The new progress that has been made in implementing China's economic development strategy is related to a whole set of economic theoretical work as well as recent domestic structural reform and the practice of international finance and trade. That the government has adopted the new development strategy also testifies to its affirmation or basic acceptance of theoretical and policy research related to the new strategy, which was suppressed to various extents by dogmatic thinking in the past. The proposition of the new strategy and its future implementation will certainly rely even more on the new theory and method of analysis, while putting an end to those conventions that have hampered thinking. Concerning the theoretical significance of the new strategy, this article proposes to stress only two points:

First, the series of discussions on the new strategy further reject the definition of the function of foreign trade in traditional economic theory, namely that of "regulating surpluses and shortages," and affirm the theory of comparative advantage and the law of shifting comparative advantage. Since the beginning of reform, the foreign

trade theory of regulating surpluses and shortages seemed to have been discarded gradually, particularly among a majority of economists, but it stubbornly rears its ugly head frequently. The long-term investment plan, for instance, betrays an effort to balance supply and demand in every industry through domestic production by a certain year in the future. In addition, for years we considered international trade a link and a weapon in the international class struggle and constantly criticized the theory of comparative advantage as a defense of the hegemonistic predatory behavior of imperialism toward developing nations. As many people have pointed out, this argument does not seem to be borne out by the practice of peaceful international trade or by an analysis of the experience of newly industrialized countries. Today, at a time when comparative advantage has yet to be given its due recognition, there are people who, exploiting the increase in protectionism in developed nations, seek to refute it along with the theory of dynamic comparative advantage and that of shifting comparative advantage. In light of the problems in practice, Comrade Zhao Ziyang has proposed that China participate in the international exchange on its strengths. Future practice would make things increasingly clear.

Second, through comparative international research, particularly that of the experience of developing nations in development strategy, the Chinese government has at last affirmed unequivocally the superiority of the export-oriented development strategy and declared that an export-oriented economy must be established in the coastal region, although not necessarily throughout the nation, a recognition of China's immense territory. For 30 years after the war, a considerable number of developing nations made import substitution their development strategy, which was also strongly favored by traditional Chinese economic theory. Since the late 1970's, however, many economists in the world began to follow with interest the experience of Asia's "four small dragons" in export-oriented development and noted that several arguments that cast doubt on the export-oriented economy, for instance, that overdependence on international trade would make for a fragile economy incapable of withstanding the trauma of market changes, had been proven by practice to be incorrect. Nevertheless, the Chinese government for a long time failed to face up to this important international phenomenon. As late as 1985, many newspapers were still constantly criticizing the fragility and gloomy future of the export-oriented economy and ignored the plea from the academic circle that we study the experience of the "four small dragons." Ideology was probably at work here, playing an obstructionist role. Also, there seemed to be a disdainful attitude toward major topics from international economic circles as far as economic system and development issues are concerned. Today the development of an export-oriented economy along the coast has been made a party and government policy. This is a change, one that also opens up a brave new world for economic research. It should be said that while China recognizes the need for an export-oriented economy, there is little research, and



even less consensus, on a string of issues, such as how to revamp our policies to support such a development and how to reconcile import substitution with the encouragement of exports. The establishment of the new strategy endorses certain theoretical research work and propels it forward, broadening as well as deepening it.

### **3. The Demand of the New Development Strategy on Structural Reform and a String of Issues To Be Addressed**

Comrade Zhao Ziyang has pointed out very clearly that the key to the implementation of the new strategy is reform and discussed at length ways of speeding up foreign trade reform.

On the relationship between foreign trade reform and the new strategy, Comrade Zhao Ziyang has given a clear explanation, of which three points are particularly noteworthy: 1) To carry out the new strategy, we must deregulate foreign trade. And deregulating foreign trade requires that enterprises assume responsibility for their own profits and losses. The assumption of responsibility for profits and losses, therefore, is a top priority today; 2) We should create a climate where one can import and export at all times. Any rules, regulations, and work style incompatible with this requirement must be changed aggressively; 3) Foreign businessmen should be allowed to manage Chinese enterprises in accordance with international practices.

No doubt these are three very important aspects. But given the glaring problems in practical work, it is difficult to really carry them out. This poses a series of issues that the economic community and policy-making departments must ponder and resolve. Right now we should try our best to study and satisfy these several demands of reform. At the same time, the economic community should look farther ahead, predicting the problems that these reforms will encounter, and suggest areas where further reform is called for in the future. This article proposes to explore certain issues that have yet to be sorted out clearly to pave the way theoretically for a yet more far-reaching inquiry into reform planning that supports the new strategy.

First, how to reconcile deregulation in operations with the phenomenon of "enterprises vying with one another to raise procurement prices and slash sale prices, resulting in an outflow of profits," and how to reconcile "deregulation, which gives rise to instant chaos, with control, which leads to instant rigidity." Both problems have plagued foreign trade reform from the beginning. The rigorous implementation of the principle of holding enterprises responsible for their own profits and losses is a prerequisite, and a very important one, for deregulation in foreign trade. However, we cannot say it is the only prerequisite. In other words, it alone does not satisfy all the preconditions. Since reform began, China

has experimented with operational deregulation to various extents on several occasions. Based on this experience and the lessons learned, we see that there are three important conditions, which manifest themselves as major contradictions at different stages.

China launched operational deregulation beginning in 1982 or thereabouts and kept it up in fits and starts for several years. A conspicuous contradiction was the wide gap between China's distorted domestic prices and international market prices, resulting in huge disparities between the profits and losses of exporters of different products. Since all enterprises were profit-driven to a large degree, there was a scramble to procure commodities with a low foreign-exchange-earning cost and dump their goods by slashing prices. People became acutely aware that the main culprit was the differences between the two sets of prices and that the way to get around the problem lay in price reform. Before that could happen, a temporary option was to set up standards for the cost of earning foreign exchange for different products. However, this method was fraught with technical problems in actual implementation. A few years later, the level of the cost of earning foreign exchange in the case of most commodities outside centralized management as well as non-quota commodities and commodities outside the plan had tended to even up in the course of this kind of abnormal competition, differences in their foreign-exchange-earning costs having diminished noticeably. A typical example is grain, oil, native, and livestock products, which used to have a rather low cost of earning foreign exchange in the past. Now their average cost has caught up with and even overtaken that of electronic machinery exports. In effect, this is a passive form of price reform involving a more reasonable redistribution of income. As a result, the gap between the two sets of prices has become less pronounced. Some people thus conclude that this is no longer a major contradiction. Nevertheless, the problem has not been fundamentally resolved and will worsen again when the scope of export deregulation is further enlarged and commodities previously not exported are opened up. The only way out remains price reform. Only price reform can close the gap between the two price systems.

Following the sharp deterioration in China's international balance of payments and foreign exchange reserves in 1985 and the short-lived bout of financial robustness induced by excessively fast growth and massive foreign exchange spending, we made export and the earning of foreign exchange our top priorities in 1986 in the interest of macroeconomic balance. New policies to encourage exports were announced before the Spring Festival of 1986 and a new procurement policy was initiated under which prices were to be set by the market. This macroeconomic policy fully exposed the weakness of eating from the big rice pot so common among foreign trade enterprises. Enterprises competed with one another destructively, more so than in the several past years, pursuing the fulfillment of export tasks exclusively with no regard for cost. In the first half of 1986 alone, the

average cost of exporting and earning foreign exchange nationwide went up 16 percent. Meanwhile, the domestic price level remained relatively stable after belt-tightening policies went into effect in the second half of 1985.

With the serious problem of eating off the big rice pot in mind, we lost no time in taking three target contracting measures in early 1987 and succeeded in curbing the rapid rise in the cost of earning foreign exchange. But we failed to control illegitimate competition and other practices detrimental to macroeconomic interests, a situation that often results from the fact that enterprises in different regions and industries enjoy varying foreign exchange retention treatments and have different economic performance contracting targets. It follows that as long as conditions for fair competition are absent, there is no assurance that deregulation in operations can proceed smoothly. In fact it may even exacerbate inter-regional market fragmentation and the irrationality of enterprise organization. Particularly at a time when the international market is changing and the domestic macroeconomic balance is unstable, competition tends to lead to chaos and easily gives rise to one-on-one bargaining between government and individual enterprises.

In short, to implement the policy of operational deregulation and ensure that there will be no "instant chaos upon deregulation," not only must we take the principle of holding enterprises responsible for their own profits and losses, but we must also be careful to close the gap between the two sets of prices and create conditions for fair competition. This in turn poses a host of issues for the contracted management responsibility system now under way across the board in China, which must be examined and resolved.

Second, we must create an environment in which all sorts of enterprises can "import and export on a large scale" without hindrance. This touches upon a string of institutional and policy issues. We must see that China today is still ridden with problems—organizational setup and functional distribution that do not make sense, bureaucratism, and unhealthy trends, etc. Thus there is vast potential for shaking up and reforming institutions and practices and improving government work efficiency. We must do our very best to improve things here. Certainly there is also this question: Just how easy and free do we want things to be? Can we achieve or come close to the degree of ease and freedom under a free trade system?

Economic theory and international experience prove that given macroeconomic stability and normally functioning market mechanisms, import and export activities and capital circulation can take place freely without hindrance. The key is a pricing (including exchange rate) mechanism that can regulate the whole range of economic activities smoothly and effectively. Coupled with a sound tax system, the pricing mechanism can also regulate all sorts of microeconomic activities and bring

them in line with the general interests of society at large and other public goals. That is to say, had we reformed the price and tax systems boldly, then many contradictions today whose resolution require government intervention, such as those between domestic sales and foreign sales, between import and import substitution, between the coast and the interior and various regions, between enterprises in different industries, and between sectors, can be solved. We would be relying more on the market and less on administrative control and the government, reserving for the latter only supervisory functions and a lesser amount of management work. Many economic activities, including import and export, will be determined by enterprises on their own, freely and without hindrance.

But just as Comrade Zhao Ziyang has noted, the problem is that "we are reforming under a highly irrational domestic price system. Herein lies the stickiest point in foreign trade reform. Given this highly complex reality, it is very difficult to come up with a good plan that would make enterprises accountable for their own profits and losses." In the absence of a sound pricing mechanism, microeconomic behavior cannot regulate and restrain itself. For instance, when it pays to export a certain product and when the domestic price of the product is low, then the product will be over-exported to the extent that domestic consumers will be seriously threatened. Consequently, there is no alternative but to impose quantitative restrictions. Or a product may generate handsome macroeconomic benefits when it is exported. Owing to irrationalities in the exchange rate, prices, and tax system, however, it is not exported. Result: the government must institute administrative measures to encourage its export, most likely on a one-on-one basis. And consider this third product. In macroeconomic terms, import substitution should be encouraged. However, because of reasons having to do with exchange rate and prices, our microeconomic behavior may actually be encouraging imports. As a result, we have no choice but to formulate a series of import regulations of an administrative nature, to the great inconvenience of the importing enterprise. The upshot is that we must make a choice between the need for administrative control and the freedom of enterprise activities.

One way out is to abandon certain areas of administrative coordination instituted for macroeconomic benefit in favor of the convenience and self-determination of microeconomic activities. Sometimes this is not a losing proposition. Bear in mind that the plan and control regulations drawn up by an administrative unit are often of a poor quality, even mistaken. It all depends on the professional caliber and work style of the unit in question. In drawing up a plan, reviewing and approving regulations, and distributing quotas, people often are highly subjective, arbitrary, and biased by special interests. Implementation, too, may be so undermined by bureaucratism and an unsound work style that the intended macroeconomic effects are not achieved. We end up paying a heavy price which sometimes even

exceeds the macroeconomic interests we seek to protect. Yet the administrative personnel of the unit concerned and the enterprise that stands to benefit have a way of lobbying the government, touting the so-called "macro-economic interests." No doubt it is tough making this kind of judgment. To take the pro-microeconomic approach, we must reckon the extent of price irrationality and project the cost of such an approach beforehand. We should not just go ahead with it and then tighten the leash after problems crop up.

Another way out is to keep administrative coordination for the sake of the macroeconomy and sacrifice some microeconomic convenience and self-determination. This approach may be the only choice when the price system is grossly distorted and the tax system hardly makes up a coherent whole. (China today seems to fit this description.) Under these circumstances, the government may apply all sorts of pressure to stamp out bureaucratism and unhealthy trends. However, if the economy is moving in the monetary direction, then we should not expect the pressure to work. Needless to say, room exists for appropriate but non-substantive improvement in specific administrative coordinating measures. This writer believes that there are ways to improve administrative coordination. For instance, we may minimize direct command planning aimed at localities and enterprises and adopt more visible open quantitative restrictions. In the distribution of quantitative restrictions, we should apply a selective quota distribution system that is openly based on competition. We should make known to the public to the greatest extent possible the operating details of the system and the treatment of vested interests. Note that these measures are no permanent cure. All they do is ameliorate the seriousness of the problem during a particular period.

Comrades who have not studied the situation in depth may assume that an optimal approach combining administrative coordination with the avoidance of bureaucratism and unhealthy trends will one day be found. Both economic theory and international experience, however, suggest that when prices are severely distorted, no solution bringing together the best of both worlds exists in reality. Similarly, given the absence of price coordination and a level playing field, combining economic deregulation with the presentation of a united front to the outside world is easier said than done. More often it is a balancing act where one gains at the expense of the other. Some comrades also argue that in the wake of the dual pricing system, price distortions have become less severe. In fact, dual distortions caused by dual pricing have wrought havoc with the import-export accounting system, given rise to much behavior at variance with macroeconomic interests, and intensified the pressure for administrative control. Then there are those comrades who contend that the above mentioned contradictions can be resolved provided administrative managerial power is delegated to localities level after level, thereby bringing the manager and the enterprise closer together. Yet given the existing distorted price,

finance, and tax systems, the interests and management objectives of local authorities are in many ways inconsistent with those of the central government. Their management in essence cannot replace administrative management by the central government.

The pricing mechanism impacts the export-oriented development strategy closely in another important way. The development of an export-oriented economy demands that large numbers of enterprises gear themselves to the international market and regularly adjust their product direction and varieties in accordance with conditions in the international market. This means that enterprises must be able to select all sorts of inputs on the market and change them very flexibly. At present, only a market system free from price control can support this kind of flexible resource allocation. Administrative resource allocation has historically proven to be rigid, slow, and even flagrantly bureaucratic. Experiments in some countries have made it clear that the absence of a flexible resource allocation mechanism could well retard the development of an export-oriented economy severely.

In short, it is the contention of this article that as far as the creation of an environment conducive to "importing and exporting on a large scale" is concerned, we have much room for improvement, on the one hand, and are essentially facing a dilemma, on the other. We should weigh the pros and cons and make a choice without delay so that we can then proceed to improve our work, knowing what we want to do. If we do not make a detailed analysis of this problem and lack a firm resolve, we are apt to flip-flop repeatedly in our policy. Another issue worth considering is whether we will be able to find an even more coherent coordinated reform that will save us from our dilemma once and for all.

Third, we must allow foreign businessmen to manage enterprises in China in accordance with international practices. This means more than inviting foreigners to be managers. It also means allowing foreign businessmen to come to China to set up Sino-foreign joint ventures, contractual joint ventures, and foreign-owned enterprises and manage them by applying successful experience abroad. China always been sincere in its desire to attract foreign capital and continuously improved the investment climate and operating conditions for foreign enterprises. However, perhaps out of a desire to make up for certain defects in its investment climate, China at one point earlier tried offering foreign investors special preferential treatment in taxes and other areas. Perhaps we have gone too far in this direction. We have adopted and are adopting a string of positive steps to improve the investment climate and operating conditions. I think some institutional barriers still remain in China, which makes it very difficult for the foreign investor to manage an enterprise here using successful examples in the world.



First, a major complaint among foreign businessmen these days is that the Chinese government is overly rigid in insisting that foreign enterprises balance their foreign exchange. This harsh insistence, largely the result of an irrational exchange rate and the fear of a shortage of foreign exchange, often prevents the Chinese enterprise and the foreign businessman from finding common ground where their interests meet. Then there are some Sino-foreign projects which may begin with import substitution before expanding foreign sales gradually. However, they often fail to get approval because of the rigid demand that they balance their foreign exchange. This is particularly true in the case of some technologically sophisticated projects. A series of measures taken recently (such as the opening of a foreign exchange regulating market) may ease the difficulty somewhat, but there is just no skirting this basic problem. In essence, restrictions on the timely and normal conversion of currency are a price problem. At one point our tendency to avoid price problems prevented us from making up our minds on the exchange rate issue.

Second, foreign businessmen demand national treatment, that is, they want to be treated like Chinese enterprises on the materials, labor, and financial market. The fact is that such markets are not really in place yet. What we do have is only a so-called raw materials negotiated-price market which exists outside the plan, a highly imperfect market where prices are often too high for exporters. This too is the outcome of the stagnation in price reform, which interferes with the establishment and perfection of a market. The negotiated prices of some means of production tend to discriminate seriously against exporting, forcing export enterprises to rely more on the international market. As a result, these enterprises cannot benefit from the accumulative advantage of low-cost labor that is realized when production is carried out at successive levels using inexpensive labor. (Put differently, they benefit from low-cost labor only in the final stage, processing.) In addition, they have to bear relatively high freight costs. Moreover, the prices of specific key elements are often determined by the productivity of the unit in the production of specific products. In other words, the prices of key elements are a function of the prices of specific products. Before commodity prices are basically rationalized, the establishment of a market for key elements will result in many practices that run counter to macroeconomic aspirations and will intensify the pressure for administrative control. This is a major reason why we cannot set up a market for key elements too far ahead. All this also has an effect on the level of fees charged by capital construction and services.

Furthermore, the foreign businessman who directly invests and manages an enterprise in China has to deal with an excess of administrative coordination (including assorted application formalities). Not only is this time-consuming and delays matters, but it also entails extra expenses. So it is a source of widespread discontent. This issue harks back to what we discussed earlier about the need for administrative coordination. There is still much

room for improvement here since arbitrary cumbersome formalities abound and numerous organizations work at cross purposes, making things difficult for one another. Be that as it may, at a time when our prices, exchange rate, and tax system are grossly distorted, we cannot but admit that many administrative coordinating measures are necessary to varying extents in protecting macroeconomic interests and enforcing the industrial policy. If we refuse to sacrifice macroeconomic interests, we will inevitably end up with a profusion of administrative coordinating mechanisms compared to other successful countries. This again puts us in a dilemma and presents us with a difficult choice.

Judging from the present situation, there is still much we can do to improve the investment climate and operating conditions for the foreign investor. But it will not be long before we learn that we have no alternative but to "bite the bullet," that is, remove the above mentioned hurdles. Only thus can we emulate and approximate success stories in the world. A phenomenon which deserves some thinking is this—the problems mentioned above relating to the utilization of foreign funds are almost identical to those in the foreign funds system. All of them are caused by distortions in the exchange rate and in the price, market, and tax systems. They are only different facets of the same problem. This also shows that in the course of shifting our economy to an export orientation, the issue of foreign funds, foreign funds utilization, and domestic structural reform are closely related.

#### **4. Firmly Shift Toward a More Export-Oriented Economy**

While reform is fraught with difficulties, we need only objectively review China's almost 40 years of economic history after the founding of the People's Republic and the economic performance of different systems and different development strategies in the world in the postwar period to reinforce our resolve to carry out economic structural reform and shift to a more export-oriented strategy. The economic community is duty bound not only to give the government powerful support in its reform and change of course at the moment, but also to look ahead and make theoretical preparation for the next step and propose policy options without delay. I now propose several long- and medium-range topics in the hope of eliciting some discussion.

1.) Further examine the international experience and find an even more harmonious arrangement combining international experience with Chinese characteristics. At present China is pushing for export-oriented development along its coast and deregulating foreign trade. Meanwhile, the international economic community is endorsing concepts like "export-oriented economy" and "trade liberalization." The World Bank has summed up the experience of developing countries which have successfully put together an export-oriented economy in

these policies: 1) a sensible exchange rate; 2) macroeconomic policies that hold inflation in check; 3) the substitution of tariff regulation for quantitative restrictions; and 4) reducing the protectionist gap and lowering the overall level of protectionism.

China's policy under the new strategy, the centerpiece of which is the contracted management responsibility system, is clearly unique. On the other hand, we cannot say that questions raised by international experience do not make sense. For instance, Section 3 of this article mentions some unresolved problems which are all related to the contracted management responsibility system. To a certain extent, the contracted management responsibility system, which makes firm arrangements for several years, hampers the adjustment of some basic policies. At a minimum, we need to study the gap between the two sets of reform measures and find out whether it is possible to close it.

2.) Examine in depth the effects of excessive import restrictions on the development of an export-oriented economy. Since China is in a developing stage, it tends to be short on foreign exchange. Moreover, certain domestic industries need appropriate protection. Hence the penchant for policies and slogans that restrict imports excessively. Yet few people question or calculate the cost of this kind of policy. The problem, however, is that while the advantages of a protectionist policy are direct, its cost is indirect, perhaps several times over. Note that overly protectionist import policies might translate into discrimination against exports in the final analysis. China today realizes the shortcomings of import restrictions in processing with purchased materials and re-exporting. Even more important, protectionist import policies encourage import substitution industries, causing discrimination against the entire export sector as mainly demonstrated in the exchange rate. Thus weighing the pros and cons of each protectionist import policy through in-depth analysis is another important topic.

3.) Study ways of creating conditions for fair competition. In the foreign-funded contracted management responsibility system today, we have largely achieved equal financial treatment nationwide for that portion of exports outside the plan, which is a gratifying step toward the realization of equal competitive conditions. The trouble is that if we depend on the gradual expansion of that portion outside the plan to bring about a level playing field, I am afraid it would take many years. Should we, therefore, consider taking certain supplementary reform measures to speed up the creation of equal competitive conditions? Would they dovetail and mesh well with the present contracting system?

4.) What kind of macroeconomic policies would help reform as well as development? Much of the analysis in this article is related to macroeconomic policies. Both overheated economic growth and ill-considered reforms

(leading to policy flip-flops) tend to create macroeconomic uncertainty and jeopardize the conditions for participation in international specialization. Overly liberal monetary and fiscal policies are apt to lead to a high price index. And when prices are high, it would be that much more difficult for us to find the resolve to introduce price (including exchange rate and interest rate) reforms that would cause additional repercussions. Inflation is frequently that part of an export-oriented economy that directly threatens the economy. Invariably it causes an inadequate real exchange rate (an overvalued currency), hence seriously affecting exports. Certainly, because of the need to correct excessively distorted commodity prices and the prices of key elements, we inevitably have to make some radical changes, something we must put up with sooner or later. But the issue is whether it is necessary and sensible to support normal economic growth with a certain form of inflation.

According to economic theory, production growth is mainly fueled by accumulation and innovations in science, technology, and enterprise organization, and is determined by the effectiveness of accumulation. A system that helps measure such effectiveness correctly and creates competitive pressure is conducive to the effective utilization of accumulated funds and provides a driving force for innovation and raising productivity. An appropriate interest rate also will help fully tap the potential of domestic accumulation. This requires that the increase in money supply as broadly interpreted more or less keep pace with the growth of the GNP. Some comrades argue that when the money supply broadly interpreted increases significantly faster than the GNP, the economy will grow more rapidly. People may ask the following questions: What is the goal of such a policy? Is this a short-term or long-term policy? Would we be paying too high a price if we let inefficient enterprises operate at full capacity? From the perspective of the export-oriented development strategy, the public cannot but be particularly concerned about this. Often it complicates policy changes that support the new strategy and may cause them to go awry. Moreover, it directly threatens the foreign trade contracted management responsibility system, which has just gone under way. To study the next phase of reform and the implementation of the new strategy, we must discuss macroeconomic policies thoroughly and weigh different options.

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#### **Economic System for Externally-Oriented Economy**

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[Article by Jin Hongxun [6855 3126 3065], Academy of Social Sciences of Fujian Province: "The Economic System of an Externally-Oriented Economy" [Abstract printed in italics.]]

[Text] *The author says: Independent commodity production enterprises are all authorized to participate in international commodity exchanges. This can hardly be*

*restricted or prevented by administrative orders. In international commodity exchanges, the decisive factor is whether the commodity is priced lower than the international parity price and still yielding a profit, and not which country and what type of enterprise has produced the commodity. We may therefore say, there is only a difference whether participation in foreign trade is direct or indirect, but no distinction as to certain enterprises being allowed and others not being allowed to participate in foreign trade.*

China's coastal regions are in the process of developing an externally-oriented economy. An externally-oriented economy is a commodity economy which stages all its major activities on the international market. Its operational mechanism is mainly regulated by the law of value in the international market, but at the same time also by the law of value in the domestic market. The economic system of the externally-oriented economy is by its very nature the economic system of commodity economy, but since it is oriented toward the international market, it has many peculiarities that are not found in the domestic economic system.

#### **I. Ownership Structures in the Externally-Oriented Economy**

Ownership of the means of production is the foundation of socialist production relations. Presently, China is still in the initial stage of socialism, and the basic characteristic of the ownership system at the present stage is a diversity of economic components, with public ownership the predominant element. With the stepped-up reform of the economic system, a change is taking place in the inner workings of this ownership system. First, the recent appearance of new public ownership forms and other forms of ownership is indicative of an important trend of change in the ownership system. Second, the policy of opening up to the outside world brought about the ownership system of Sino-foreign joint ventures, which signifies yet another trend in the changing ownership system. Under the old economic system, there was foreign trade, but no externally-oriented economy to speak of, and state monopoly was the system of foreign trade, an area closed to any other type of enterprise. Opening up to the outside world broke down the barriers surrounding this forbidden zone. Foreign trade activities are now open not only to enterprises outside the official foreign trade system, but also open to enterprises that are not owned by the whole people, so that enterprises with all kinds of ownership systems can join the surging development of the externally-oriented economy, which is now in the process of restructuring the whole foreign trade system.

Commodity economy knows no national boundaries, a fact which results from its inherent nature. Due to the rapidly developing productive forces and social division of labor, commodity exchanges are continuously expanding. The original markets of the various countries can no longer accommodate all commodities, and this

fact impels the commodity economy to break down national boundaries and expand into the world. Socialized large-scale production based on modernized productive forces made commodity economy into a worldwide phenomenon and promoted international commodity exchanges. Specifically, several socialist countries have in recent years come to realize that commodity economy is a stage that cannot be evaded by socialist society, and they have gradually adopted policies of opening up to the outside world and of participating in international commodity exchanges, as a result of which the world market has greatly expanded. This consequential circumstance of commodity economy becoming an international phenomenon gave independent production enterprises the power to participate in international commodity exchanges, a fact which can hardly be restricted or prevented by administrative orders. In the international commodity economy, the decisive factor is whether a commodity is priced below the international parity price and still yielding a profit, and not whether this commodity is produced by what country or by what type of enterprise. What is recognized here is the principle of exchanges at equal value, and not any principle of ownership. This is the theoretical basis on which China's enterprises of different ownership structures are entering the international market. We may therefore say, there is only the difference whether participation by enterprises in the international market is direct or indirect, and no distinction whether certain enterprises are allowed and others not allowed to engage in externally-oriented activities. This is the theoretical foundation shaped by the ownership systems of the externally-oriented economy.

Structurally, the ownership systems of the externally-oriented economy may be divided into three large categories according to their composite elements, namely the ownership system of Sino-foreign joint ventures, the ownership system of foreign financed enterprises, and the ownership system of domestically financed joint enterprises. The ownership system of Sino-foreign joint ventures is a product of opening up to the outside world. Only by cooperation with foreign capital in enterprises operating in China or abroad under the conditions of opening up to the outside world could the ownership system of Sino-foreign joint ventures come about, a system which combines socialist ownership and capitalist ownership elements. It is a kind of state capitalist economy, but compared with Lenin's statement, "a capitalism on which we can impose restrictions and of which we can control the scope of its activities," it has a more positive significance, as it is capitalism developed as required in the initial stage of socialism. It is our opinion that we must follow the trend toward further appropriate expansion of our opening up to the outside world, and must initiate even more "opened-up" ownership systems in the course of our development of the externally-oriented economy.

First, we must further perfect and develop the ownership system of "domestically guided" Sino-foreign joint ventures, which means that we must exert efforts to develop



Sino-foreign joint ventures with the special characteristic of attracting foreign capital and importing technologies. First, as to the forms of the ownership system, in addition to further consolidation and perfection of such industries as Sino-foreign joint ventures and cooperative business operations, cooperative production enterprises, and the "three forms of processing and compensation trade", we must gradually expand leasing enterprises, joint development enterprises, and joint scientific research and production entities, to encourage diversity in production. At the same time, we must appropriately develop foreign financed enterprises. Second, as to the levels of ownership systems, in addition to having enterprises wholly owned by the people engage in cooperation with foreign capital, we must actively develop various collectively-owned enterprises, especially town and township enterprises and have them too cooperate with foreign capital and operate as "three forms of processing and compensation trade" enterprises, also allow private enterprises to establish suitable cooperation with foreign capital. Third, as to content and scope of operations, apart from industry, we can also develop tourism, foreign trade, finance, and other such branches of commerce.

Next, we must energetically develop "externally guided" joint ownership enterprises whose main objective is to earn foreign exchange through exports, i.e. energetically develop joint enterprises mainly domestically financed, but oriented toward the international market, their main purpose being to participate in international division of labor. Specific forms of these are: 1. Combined ownership system enterprises relying on foreign trade enterprises owned by the whole people. The main ways to set these up are: (1) To energetically develop comprehensive joint ownership enterprises or "product-production" type joint ownership enterprises of the foreign trade system within a system established by export production bases; (2) To energetically develop comprehensive-type or "product-production" type combined ownership enterprises that transcend system boundaries, backed by foreign trade enterprises; (3) To energetically develop enterprises of combined ownership systems that transcend provincial boundaries and have certain ports as centers, backed by foreign trade enterprises. 2. We must develop enterprises of combined ownership systems, a type of conglomerate enterprises, directly transacting foreign trade. Developing conglomerate enterprises whose main purpose is to earn foreign exchange by exports is an important form of lateral linkages of enterprises, which we may call domestically-linked enterprises of the type of conglomerates oriented toward the international market. This type of enterprises is not restricted by provincial borders. With export products as their leading line, they are combines that span large areas and are of benefit to producers of all kinds of commodities. Selecting export products which are competitive on the international market, we must energetically develop conglomerate enterprises of an export-type combined

ownership system, according to the principle of specialized cooperation and mutual benefit. 3. We must establish and develop foreign trade joint enterprises of local and nongovernment nature. As mentioned earlier, under the conditions of commodity economy, independent commodity producers are authorized to participate directly in international competition, but because commodity economy is not yet well developed in China, not every enterprise has the capability of directly dealing with foreign parties. We must, therefore, first convert the unified agency system of the state foreign trade enterprises into a system of local foreign trade agencies, and energetically develop local trading enterprises. At the same time, we can also develop nongovernment enterprises, mainly to act as agents for town and township enterprises and for private enterprises in their import-export activities. Later, a system of diversified foreign trade enterprises would be formed that would conform to an ownership structure in which different economic components would coexist but in which public ownership would predominate. 4. Development of "externally guided" enterprises jointly owned by Chinese and foreign capital, which means to gradually develop Sino-foreign joint venture enterprises abroad. Under the conditions of an increasingly active flow of international capital, the appropriate expansion of investments abroad would be an important part of the externally-oriented economy. We must provide favorable conditions for the gradual development of enterprises abroad which would be jointly owned and jointly operated by Chinese and foreign capital.

## II. Management System in the Externally-Oriented Economy

Only by organizing and directing externally-oriented enterprises according to the commodity circulating rules of the international market will it be possible to break into the international market and to promote domestic economic development; the management system of the externally-oriented economy must conform to this objective demand. The externally-oriented economy in China's coastal regions is now in the initial stage of this development. Its management system has not yet assumed shape, and is awaiting further experimentation and perfecting in the course of the actual practice of international exchanges.

### 1. Market Mechanism of the Externally-Oriented Economy

To organize and direct foreign economic activities according to the rules of commodity exchanges in the international market, it is, first of all, necessary to master the operational mechanics of the international market and its relations to the domestic market. Generally, the international market is divided, according to the different commodity exchange activities, into a commodity market, a capital market, a labor market, and a technology market. Due to the different character of commodities traded in these markets, forms of operations also

differ. Every commodity exchange, whether on the international or the domestic market, is bilateral. Under the conditions of an externally-oriented economy, it is this kind of bilateral quality that is mainly displayed in the activities on the international market. We shall explore in the following the trading mechanism of the different markets. 1. The international commodity market. After the war, it was characteristic of the international commodity market that supplies exceeded demand, and that protectionism prevailed. In China's commodity market, demand exceeded supplies, and it was essentially a seller's market. However, since productive forces are still not yet well developed, and since China is in the era of the four modernizations, it is not only impossible to achieve a balance of supply and demand by expanding imports, but China has to implement a policy of encouraging exports and restricting imports. 2. The international capital market. The international capital market is a product of the internationalization of capital. The international flow of capital follows certain rules, namely it frequently follows in direct proportion the trends of economic development. In times of economic development, capital becomes correspondingly scarce, interest rates go up, turnover is speeded up, and the capital market becomes active. In times of economic depression, there will be a corresponding oversupply of capital, interest rates will fall, turnover will slacken, and the capital market will experience a slump. China's relation with the international capital market is different from its relation to the international commodity market in that China is a capital-importing country, and will for a long period of time be in need of massive foreign capital. 3. The international labor market. Labor is an important element of the productive forces, and within a certain scope it conditionally circulates in the world, and thus forms the international labor market. Presently, the main characteristics of the international labor market are that the developed countries export high-grade labor, that the developing countries export common labor, and that the main demand is created by international engineering contracts. China has an abundance of labor, and for a certain period of time has a surplus of labor; China is therefore eager to export labor in the international labor market. 4. The international technology market. As a consequence of the rapid development of science and technology, the international technology market has gradually become an independent international market of its own. Presently, the international technology market handles mainly technology exchanges between the developed countries, but there is a growing trend of having developed countries transferring technologies to the developing countries. At the same time, some of the developing countries too are starting to export technologies. Due to backwardness in science and technology, China will be a technology-importing country for a long time to come, but should make efforts to create as soon as possible conditions which would enable it to export technologies. Only by mastering the above-related peculiarities of the international market, and understanding China's position in these markets, will it be possible to plan a feasible externally-oriented economic system.

## 2. Control Mechanism of the Externally-Oriented Economy

The control system of the externally-oriented economy is built on the foundation of an operational mechanism which incorporates elements of the international and elements of the domestic markets, but preponderantly the former; its control mechanism is of the following kinds: 1. Economic decision-making mechanism. Provincial regions which have developed externally-oriented economies have, relatively speaking, larger economic decision-making powers. The Chinese Government allows these provincial regions to implement special policies and to enact flexible measures, different from those in other regions. Decisions on minor day-to-day operations are essentially or completely left to the externally-oriented enterprises themselves. 2. Economic regulatory mechanism. The regulatory mechanism of the externally-oriented economy is predominantly market regulation, and furthermore predominantly a double market regulation, namely one concerning the international market and one concerning the domestic market, with the international market constituting the dominant factor. Between plan regulation and market regulation, the market regulation is dominant. In other words, the economic development of these provincial regions must be geared to the international market, and follow its rule of changing supply and demand, pricing mechanism, the changing trends of exchange rates, and levels of interests, when effecting adjustments, and must, furthermore, accord with the state's compulsory planning. 3. Profit and motivation mechanism. While giving primary consideration to ensuring that the overall benefits of the state are not harmed, we must, first of all, respect and recognize the rights of the foreign investors and firms, and in our dealings effectively take into account the interests of both parties. Next, we must respect and recognize the interests of the provinces that develop externally-oriented economies, and must harmonize the relationship between the central authorities and the provinces, as well as between the provinces and the local entities, as far as profits are concerned. At the same time, we must recognize and respect the interests of the managers and workers in the externally-oriented enterprises, these being different from the interests of managers and workers in ordinary enterprises. 4. Operational mechanism of control and organization. In externally-oriented economy, economic activities are mainly carried out on the principle of having operations bring benefits in the international market. First, operations must be organized, with mainly indirect control. Next, operations must be organized with a service-type organization as intermediary. Third, operations must be organized under the supervision and control of banks, tax, insurance, customs, industry and commerce administrations. 5. Economic information transmission mechanism. Promoting economic development with an orientation toward the international market requires prompt access to fast-changing market information. The information transmission system may be vertical, based on branches

of trade or administrative jurisdictions, but may also be a lateral information transmission system linking up enterprises within a trade, or one between trades and between departments. Relevant information is mainly derived from the international market, and should be transmitted by means of modern information methods. The accumulation of a huge amount of information is an indispensable condition for the development of an externally-oriented economy.

### 3. Regulatory System of the Externally-Oriented Economy

Regulating an externally oriented economy is an economic activity which, according to the objective demands of the international commodity exchange rules, promotes foreign-oriented economic activity by means of an appropriate systematic regulatory method and system. 1. The regulatory patterns of externally-oriented economy. The regulatory pattern of the externally oriented economy is determined by the content and internal linkages of various economic activities of foreign trade. The advent of different regulatory patterns is closely related with the level of economic development in the various countries, their capacity for foreign economic activities, especially their export capacity and investment capacity, as well as with the economic developmental strategy at different times, international income and expenditure, amount of circulating currency, and foreign exchange reserves. Generally, at the initial stage of external orientation, a control-type regulatory pattern is followed, and at a high degree of external orientation an open-type regulatory pattern is followed. Countries and territories with a low level of economic development, poor export capability, and little foreign exchange reserve will follow a control-type regulatory pattern. Countries and territories that are economically highly developed, have strong export capabilities, and abundant foreign exchange, will follow an open-type regulatory pattern. At its present stage, China's foreign trade regulation is one of encouraging exports and restricting imports, with a control-type foreign finance regulation, and this will have to be at the core of determining all the various regulatory patterns. 2. The regulatory framework in the externally-oriented economy. We have to start out from China's national condition, draw on the international experiences, and build up an appropriate regulatory framework. Macroeconomic regulation of the externally-oriented economy must have foreign trade at its core, to form an organic regulatory system in integration with credit, tax revenue, and foreign exchange regulation. Regulation of foreign trade must be carried out in two directions. First is policy regulation. For a considerable period of time, China will have to implement a policy of encouraging exports and restricting imports, and will have to give primary consideration to exports to earn foreign exchange. Second is the management system. To establish a foreign trade system which integrates central, local, and private foreign trade enterprises, upholding joint unified principles in external relations, carrying out a system of agency operations in open

business operations, with responsibility for one's own profits and losses. Around this foreign trade regulatory method, public finance, tax revenue, private finance, and foreign exchange regulatory measures are to form a whole entity. In conformity with these foreign trade regulatory measures of encouraging exports and appropriately restricting imports (consumer goods), the treasury should give necessary export subsidies. As to tax revenue, apart from instituting a system of tax refunds for exports, a fair customs duty should be levied on imports. As to financial regulation, we must adopt different regulatory measures, according to differing circumstances; the administration of foreign exchange must be appropriately controlled, and in case of need, adjustments should be carried out by means of a well organized foreign exchange market; it would not be the right thing to open it up too early. To sum up, as to the regulation of the externally-oriented economy, and of the trade and finance of its enterprises, our primary objectives must be to export in order to earn foreign exchange, to utilize foreign capital, to import advanced technologies, and to organically integrate the regulatory methods in the various departments.

### III. Integration of Macro- and Microeconomic Management of the Externally-Oriented Economy

The externally-oriented economy is composed of an externally-oriented economy of national or regional scope and of the foreign economic activities of economic organizations. These externally-oriented enterprises and economic organizations, for which the international market is the principal stage of commodity exchange activities, carry out the necessary and appropriate macroeconomic guidance and have their microeconomic activities conform to it. This is an important and large task for the management system of the externally-oriented economy.

#### 1. Relationship Between State, Market, and Enterprises

The relationship between state, market, and enterprises is actually a problem of integrating macroeconomic direction with microeconomic activities; they are the three main structural components and levels of the economic system, their linkage point is the market. The mutual relations between the three, and their degrees of dependence, is of great relevance for the developmental form of the economy, whether it is to be a closed or an open economy. Under the system of a planned commodity economy based on the system of public ownership, enterprises are independent producers of commodities; they are legal persons and have their own independent rights, responsibilities, and interests. On the one hand, they accept the state's macroeconomic direction and necessary controls, and, on the other hand, they are free in many more respects to manage their own production and business activities, according to the demands of the law of value and geared to the needs of the market. Development of the commodity economy requires not only a consumer goods market, but also a market for the



means of production, thus building up a socialist market system. Enterprises cannot do without a market, the macroeconomic direction of the state is effected through the market, thus the state regulates the market, and the market guides the enterprises. Under these conditions, the forms, methods, and the substance of macroeconomic control are all experiencing radical changes, namely a shift from controlling production and business activities of enterprises to establishing a comprehensive equilibrium in the macroeconomy, from a control by singular administrative directives to an administration which employs primarily economic means but combines them with administrative and legal measures, from a direct control of enterprises to controlling the enterprises through the market, and effecting a close linkage of macroeconomic direction with microeconomic activities, with the market as the point of linkage. The management of the externally-oriented economy, apart from these common factors, has also its own peculiarity, namely as the principal stage for the business operations of enterprises. In the international market, production and sales activities are conducted mostly with the international market as intermediary. Enterprises must, therefore, first of all, possess adaptability to influences of the international market, have a suitable internal organizational structure in this respect, must be motivated, must have a profit mechanism, and decision-making procedure, all apt to respond to changes in the international market. Externally-oriented enterprises must not merely excel in the key factor of business operations, but must also build around this key factor a self-circulatory mechanism, develop a strong and effectual business system, at all times be promptly receptive for any demand information from the international market, and according to the changes in demand in the international market must continuously adjust the direction of business operations. In its administration of externally-oriented enterprises, the state must, according to the changes in the international market and in international economic relations, employ economic means to regulate the international market, such as customs, exchange rates, and interest rates, to accurately guide their business direction.

## **2. Intermediary Organizations Between Externally-Oriented Enterprises and Macroeconomic Controls**

Under the closed and excessively centralized economic system of the past, the state's control of the enterprises was exercised directly through control by local authorities or by departments, a system that violated the objective rules of commodity economy development. As macroeconomic control is now shifted to indirect control, the direction and control of externally-oriented enterprises must count on the assistance of certain intermediary organizations. Externally-oriented economy is, first of all, a commodity economy, an economy of exchanges at equal value. Apart from this inherent authority of equal value, there is no other external authority, and government organs with the power of

representation, controlling with administrative methods, cannot possibly achieve any good results. Second, externally-oriented economy is a commodity economy directed toward the international market; its trading partners are foreign businessmen. They will look for economic legal persons and not for administrative organs to trade with. It is therefore most necessary to establish intermediary organizations, which should accord with the principles of commodity economy, and which could then coordinate and control matters, according to the operational mechanism of the commodity economy, by rendering various services. In concrete terms, it should be possible to set up externally-oriented nongovernment trade associations. As far as the externally-oriented enterprises are concerned, these trade associations would be their own representative organs and not government administrative organs. They would facilitate the transmission of information and opinions to the government, and as far as the government is concerned, its principles and policies would be implemented through these nongovernment intermediary organizations, the trade associations, which would be a more convenient way and a more practical way as compared with direct control, and would in fact simplify government and delegate authority. As to the foreign businessmen, it would benefit them to have someone acting in the capacity of a trade association and legal person to contact and transact business with. At the same time, since the trade association is a service organization, it would not domineeringly order the externally-oriented enterprises and other economic organizations about, but would mainly act in the capacity of intermediary between government and enterprises to harmonize their mutual relations, and render service to all concerned. The international market is a developed commodity market, a series of transactions, directly or indirectly related with commodity exchanges, could not possibly be achieved in reliance merely on enterprises alone. The mentioned type of service-oriented organization interposing itself in between to adjust certain relations between the international market and the enterprises, would be extremely beneficial for the enterprises. China's foreign trade organs are still rather weak, little adapted to respond to trends in the international market, also little adapted to respond to trends in the lively development of the externally-oriented economy in the coastal regions. Establishing this type of a service-oriented intermediary organization would be one of the effective ways to make up for the shortcomings mentioned.

## **3. Establishing a New Type of Externally-Oriented Economic Mechanism, With Town and Township Enterprises as Predominant Entities**

In conformity with setting up an ownership system in which public ownership would predominate and coexist with a variety of economic components, the development of an externally-oriented economy must include, in addition to the predominating state-run enterprises, enterprises of a variety of economic components to

participate in the development, forming an operational mechanism of a great variety of patterns. Particularly town and township enterprises, because not restricted by old conventions, are most apt to abandon the current economic system and establish a completely new externally-oriented economic structure. Establishment and development of an externally-oriented economic structure, with town and township enterprises as predominating entities, and operating on the commodity exchange principles of the international market, can be carried out in three directions. First, establish an externally-oriented production organization. On a worldwide scope, production for international commodity exchanges is a "production to order," a production organization that produces directly for the demands of the international market. Taking direct aim at the international market, an attitude that people always talk about, means to target accurately at the various demands in the international market, therefore to develop into a "production to order," which is an important prerequisite for a direct orientation toward the international market, as it is also the essential way to thoroughly change the old system of production, when marketing had to depend on whatever had been produced. Because town and township enterprises are small-scale operations, they are highly adaptable, quick to shift, and therefore suited to carry out this kind of "production to order" system. Second, direct access to the marketing system of the international market. To be able to occupy even a small space in the international market with its rapid changes and fierce competition, it is necessary to make full use of an international marketing network and marketing organization. Although there is little modernized management in town and township enterprises, although they may lack qualified people for export marketing, and although they have certain difficulties in joining the international marketing system as individual independent enterprises, combined together and assisted by some intermediary organization, they may well be able to join this marketing system. 3. Implementing pricing principles and the foreign exchange rate system prevailing in the international market. This question is most difficult to solve when considering participation by China's enterprises in the international competition, but following the price reform and establishment of a foreign exchange regulating market, town and township enterprises will also have certain conditions in their favor for breaking into the international market at international prices and exchange rates. Establishing a new type of externally-oriented economic mechanism with town and township enterprises as the main component, can be substantially helped by an intermediary organization. There are two kinds of intermediary organizations: one is the state or private foreign trade organizations which act as export agents for town and township enterprises, and the other is overseas Chinese financed enterprises, joint ventures, or foreign-financed enterprises cooperating with town and township enterprises. These two types of intermediary organizations can be combined and promote a foreign trade orientation among town and township enterprises, but the latter intermediary organization is even

more beneficial for the establishment and development of an externally-oriented economic mechanism among town and township enterprises, which would completely conform to the demands of the international market. This is so because: 1. Overseas Chinese financed, joint venture, and foreign-financed enterprises generally conduct "production to order," and town and township enterprises can emulate them and also shift to a production to order system. 2. Overseas Chinese financed, joint venture, and foreign-financed enterprises have all their own marketing networks, and those town and township enterprises that cooperate with them, may break into the international market by means of these networks, which would be easier than exploring the international market on their own. 3. Overseas Chinese financed, joint venture, and foreign-financed enterprises conduct transactions completely according to pricing principles and the foreign exchange rate system of the international market. Cooperating with them is helpful in guiding town and township enterprises to also follow these principles and adopt this system.

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#### **Foreign Trade, Investment, Development of National Economy**

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[Article by Huang Jianping [7806 0494 1627], doctoral candidate at the Beijing University of Foreign Economic Relations and Trade: "Foreign Trade, Foreign Investment, and the Development of the National Economy"]

[Text] China's economy is a low-level open economy. Figured according to amounts involved, the primary position in the opened-up sector of the economy is occupied by import-export movements, which in 1987 amounted to \$67.338 billion<sup>1</sup>, while the inward and outward circulation of capital was limited. From 1979 to June of 1987, foreign loans amounted to \$22.838 billion, and direct foreign investments amounted to \$7.262 billion.<sup>2</sup> Movement of labor was also of rather limited proportions. In 1987, China's foreign engineering contracts and involvement in enterprises with labor cooperation amounted to only \$1.105 billion. China's labor force abroad numbered somewhat over 60,000 persons.<sup>3</sup> We see from these figures that foreign trade and the utilization of foreign capital are the primary aspects of China's open economy.

In foreign trade and in the utilization of foreign capital, China's most basic problems are creation of foreign exchange by exports and attraction of direct investments from foreign countries (hereafter "foreign investments"). Of the two, exports are the key issue, because exports are the most important means of all international exchanges and international division of labor, as also the foundation of all other open-economy components. The advantages gained from attracting foreign

capital are that it can, on the one hand, improve the ratio of domestic production among the constituent factors of the economy, and thus increase national economic strength, and, on the other hand, that it introduces a risk factor of the foreign investing firms, and thereby reduces foreign loan risks of the state.

Obviously, at least in the case of China, success or failure in the issues of foreign trade and foreign investment decides success or failure of the open economy, and success or failure of open economy signifies success or failure of the entire national economy. It is, therefore, absolutely necessary to study the problems of foreign trade and foreign investments under the aspect of the overall development of the national economy as a whole.

### **I. Adverse Impact of the Present State of Foreign Trade and Foreign Investments on the Development of the National Economy**

#### **Foreign Trade**

The present state of China's foreign trade does not benefit China's national economy. The foreign trade multiplier theory of macroeconomics, allows us to do a marginal analysis of the functional relationship between exports and national income during the period of the Sixth 5-Year Plan.

According to the formula:

$$\Delta Y = \frac{1}{1-C} (\Delta I + \Delta X - \Delta M)$$

in which,  $\Delta Y$  is the foreign trade multiplier;

$C$  is the marginal consumption trend;

$\Delta I$  is the variable total amount of investments;

$\Delta X$  is the variable total amount of exports;

$\Delta M$  is the variable total amount of imports.

The computation (omitted) results in:

$$\Delta Y = 2,946^4$$

Using the foreign trade multiplier as parameter, we discover through further calculations that China's exports can increase national income by \$31.706 billion every year, but deducting from this figure the factor of intermediate products to be imported, the average increase per year that increasing exports can add to China's national income is only \$10.339 billion. If we take 13.22 percent as the marginal trend of income from public finance in the national income, then exports can generate only \$1,368,800,000 financial income, which is insufficient to make up for the x billions of the state's financial subsidies. This analysis is, of course, not very

precise, but it supports the view that because of strong domestic demand, and the decline of prices in foreign transactions, and in addition the high estimated conversion rates, many Chinese export products, if diverted to domestic consumption, contribute more to the national income than if exported. As to contributions to the national economy at the present stage of China's foreign trade, exports are not of economic benefit, and imports bring mainly social and technological benefits.

As to imports, I calculated the elasticity of income demand in China's imports, the ratio of imports in income, as well as the marginal import trend. Compared with developed countries and other developing countries, China's imports take up too much of the income of the national economy. There is a discrepancy between the volume of imports and the level of the national economic development. It is generally believed that if increasing national income is used excessively to pay for imports, it will adversely affect the transmission function of the national income, creating insufficiency of domestic demand and resulting in a "leak." Without doubt, a situation like this, if allowed to continue, will be harmful to the country's long-range developmental objectives.

#### **Foreign Investments**

Conflicts between foreign investments and the development of the national economy become primarily apparent in inappropriate investment amounts and investment structures. The success or failure of a country's use of foreign investments must be decided by whether the foreign investment suits the strategy of the country's economic development, and not by irrational efforts to achieve a balance of foreign exchange income or raising the level of technology imports. Under this aspect, we see that China has presently not been fully benefited by foreign investments.

It is common knowledge that China's current foreign investment policy is a narrow policy that concentrates on gaining foreign exchange. All regulations and detailed rules are formulated around the question of foreign exchange. Actually, the idea that foreign investments can bring in additional foreign exchange is very unrealistic. The experiences of all countries of the world clearly show that by only accepting the internal rate of profit of joint ventures (this is the condition that foreign investing firms seek to achieve primarily) as positive figure, the outflow of total foreign exchange from foreign investment projects will always be larger than the total inward flow of capital. During the period from 1970 to 1983, capital to the amount of \$2,785,500,000 was brought into Indonesia, but foreign exchange up to as much as \$26,053,300,000 left the country as profits from investments, reaching as high an outward/inward ratio as 9.3.<sup>5</sup> According to statistics, the average outward/inward flow ratio in developing countries using foreign investments is 1.5 - 1.8.<sup>6</sup> In comparison, the outflow of foreign



exchange from Chinese joint venture enterprises is actually much more serious than world averages. In 1985, the total imports of joint venture enterprises alone amounted to 2.7 times their exports!<sup>7</sup>

Another objective of China's foreign investment policy is the importation of technologies by means of joint ventures. Due to the discrepancy between this policy and the overall development strategy of the national economy, this objective has essentially never been achieved. According to statistics, during the period from 1981 to 1985, 60 percent of foreign investments in China were in nonproductive areas.<sup>8</sup> In the judgement of members of the State Planning Commission, who were concerned with these matters, even in the extremely limited number of joint ventures of a productive nature, the imported technologies were essentially not high-level, superior, and top-notch technologies, which, therefore, made little substantial contribution to the national economy.<sup>9</sup>

The main reason for the above mentioned two phenomena is the contradiction between Chinese and foreign investment motives. China's motives are mainly to gain foreign exchange and technologies, but the main motive of the foreign parties is to enter the Chinese market. Because of the limited export capabilities of foreign parties and China's shortage of foreign exchange, and due to the fact that products of the joint ventures are sold domestically at prices based on prices in foreign exchange, China could not gain net foreign exchange income in its foreign trade activities using foreign investments, and also did not save on foreign exchange expenditure by any import substitution.

Of course, we must still not underestimate the role of foreign trade or foreign investment in the development of the national economy, though presently of little direct economic benefit. There are three reasons for this: (1) Domestic prices and exchange rates are all twisted and contorted, so that economic benefits computed on the basis of these prices and rates also become twisted and contorted; (2) Since planned economy still predominates in foreign trade, the state can use administrative measures to reduce the harm from too low a rate of economic benefits; (3) The area of foreign investments is in China essentially independent from the main body of the domestic economy, and is not involved in the domestic system of economic circulation, such as of materials, finance, and manpower. In this way, its comparatively low economic benefits have only a limited impact on the national economy. On the other hand, its huge indirect benefits, such as managerial techniques, cultural influences, training of staff and workers, etc., cannot be realized in any other form of foreign economic relations.

## **II. Greatest Benefit of Foreign Trade and Foreign Investments Must Be Their Contributions to the Development of the National Economy as a Whole**

### **Foreign Trade**

Most developing countries would find it hard to imagine having as favorable a foundation for development as China has—such as its perfect production structure,

abundant manpower resource, and huge market potential. Just as Japan, South Korea, and Singapore, countries and territories that lack these conditions, had to choose their particular roads of development, China too must make full use of its favorable conditions and go China's unique road in foreign trade development. Of course, China, too, is faced with some real problems: the extremely uneven developments between the various regions within China, and the different levels at which the various regions participate in the international division of labor; the huge rural population of China, which are certainly in for hard times when manpower will have to be shifted between occupations; the long-term rigidity of China's economic structure, which will impede the development of the productive forces, etc.

The American experience can demonstrate to us the rule that the "precondition for the development of foreign trade has to be development of the national economy." In its early years, the United States exported little and relied mostly on raw materials for its exports. In 1850 America exported \$50 per head of population, and raw materials made up 62 percent of its exports. At the beginning of the 20th century, American domestic industry had developed beyond the level of its agricultural development and had built up a strong domestic economy, as a result of which its export structure radically changed, and the volume of its exports doubled and redoubled. In 1960, America exported \$200 per head of its population, and raw materials made up only 13 percent of its total exports.<sup>10</sup> The World Bank once made a quantitative analysis of the relationship between exports and economic growth in the developing countries, and the final conclusion was that exports would benefit the domestic economy only when the country in question had reached a certain level of economic development.

In summing up the above, we see from the standpoint of benefits for the entire national economic development, that China's development of foreign trade must follow three principles:

1. Strategic deployment in foreign trade must give first consideration to the regions (horizontal functional lines) and second consideration to the trades (vertical functional lines). On the one hand, there is a great discrepancy in natural resources (including manpower resources) and market capacities between the eastern, central, and western regions of China, which means there is a lot of room for mutual supplementation, but also a hidden potential for mutual exclusiveness. One can foresee that in the future quest for resources and markets, there will be growing contradictions between the different regions. The structure of foreign trade must, therefore, allow each region to open up new resource bases and product markets, according to its special conditions and local capabilities. It would mean that in

the new domestic and foreign environment, we must readjust the production structure and market patterns (like opening up overseas markets, or yielding a part of the domestic market), according to the region's most favorable condition and as a result will achieve the most favorable progress in the regional economy. On the other hand, China's present production structure is the direct product of the old economic system, which did not conform to the objective laws of economics. Its heavy industry had been fairly well developed in a capital and technology intensive pattern, but it was also completely developed in reliance on administrative planning, and failed to rely on objective conditions for development. On the other hand, labor-intensive light industry was relatively neglected, which means that China's advantage in its manpower resource could not be fully brought into play. To effect a turnabout in this situation, it is necessary to redetermine production policies and achieve an optimal production structure on the basis of regional development strategies.

2. The decisive elements in the development of foreign trade are not the foreign trade enterprises but the production enterprises. Vitality of the foreign trade enterprises, which exist only in the area of circulation, presupposes vitality of the production enterprises, which actually create wealth. For many years, the foreign trade enterprises have always been the core of the structural reform of foreign trade. In this way the "revitalized" foreign trade enterprises had to have dealings with the still "dormant" production enterprises. The capabilities and the enthusiasm of the production enterprises have not yet been mobilized, and while the export "pie" remained the size it has always been, what was first increased were the "mouths," so that the situation became one of "purchases at elevated prices, cutting prices in competitive selling, and profits flowing into other people's pockets." At the same time, the contradictions between the foreign trade enterprises and the production enterprises in the distribution of profits, grew daily sharper. In the microeconomic sphere, it shows up in the haggling about prices between the foreign trade enterprises and the production enterprises, both resorting to various unsound measures. In the macroeconomic sphere, these contradictions appeared at a higher level and were resolved by financial subsidies of the state, adding to the financial burden of the state. According to one investigation, among all the production enterprises investigated, 50.8 percent of Shanghai's enterprises and 61.2 percent of Jiangsu's enterprises did not want to export their products anymore.<sup>11</sup> This shows that the lack of capability and enthusiasm among the production enterprises is the principal cause for failure in the development of exports.

3. A change in the export commodity structure and any redoubling of amounts of imports and exports must be achieved on the precondition of economic development and technological progress. At the current level of China's development, a huge price will have to be paid for the change in the export structure and the redoubling of

amounts of exports. Merely for increases in imports and exports, the state must not sacrifice other even more important indices of the national economy, such as national income, finance income, per capita income, commodity price levels, employment situation, and balance of international payments. The state must attach importance to the huge role of the domestic market for the structural change and quantitative increase of exports, and must pay attention to the linkage of domestic and foreign markets through the exchange rate, thereby achieving a unison of economic benefits and quantities of exports.

### Foreign Investments

As stated earlier, China's current foreign investment policy is a narrow one as it focuses on foreign exchange income and not on benefits for the entire national economic development. One of its faults is that it limits the development of a foreign investment, restrictively, to the extent of the planned foreign exchange amounts that the foreign investment enterprise can achieve. The feasibility of a foreign investment project is not determined by its overall economic benefits, but by its capability to produce foreign exchange. This partiality toward foreign exchange is due to China's present short-range and man-made shortage of foreign exchange. The term "short-range" is used here in relation to the long-range nature of the national economic development. The term "man-made" is used here because this shortage can be remedied through domestic price increases (as in 1985), or by a change in the external circumstances (as in 1984), but it may also be further aggravated by a restrictive foreign exchange policy (as in 1986).

The conflict between the shortage of foreign exchange and the development of the national economy restricts further development of foreign investments. Obviously, many foreign exchange projects are beneficial for the long-range development of the national economy, but they certainly can aggravate the short-term pressure of China's foreign exchange shortage. However, whether we can further develop China's use of foreign exchange will mainly be determined by whether we can successfully open up more of these kinds of projects, because in these projects lies the potential for China's use of foreign investments. China's current foreign investment policy, with its shortsighted emphasis on foreign exchange, has already become the main obstacle for China's further development of foreign investments, and has already rejected or chased away many potential investors. In efforts to attract foreign investments, we must therefore realize that foreign exchange alone is not what China is after; it is only the means to realize our objective (namely the development of the national economy). Any determination of China's foreign investment policy must consider as the primary factor the overall benefits for national economic development.

### III. Proposed Plan of a New Structural Reform of Foreign Trade and Foreign Investment

#### Foreign Trade

In a perfect future system of an open economy in China, foreign markets must be the marginal factor for the realization of maximum profit for the domestic production enterprises (and their affiliated enterprises abroad). The ultimate objective of the reform of the foreign trade system must be identical with the macroeconomic developmental objective of the national economy, and foreign trade must become the only way for production enterprises to reduce costs, for their self-development, and for their victory in competition. The main measures to be taken in the reform of the foreign trade system must therefore be: contracting for the state's import tasks at different levels, ensuring the requirements of foreign exchange for national economic construction, establishing a foreign exchange market, adjusting import-export costs, fully authorizing the production enterprises to transact foreign trade, and having them assume the main role in China's exports.

The need to contract at different levels for the state's import tasks is determined by the present uneven levels of development in the various regions of China. It will give effect to the different favorable conditions of the various regions. While giving primary consideration to ensuring foreign exchange for the state's key economic construction projects, the contracting plan must pay attention to a variety of economic means to stimulate export enthusiasm in the various regions. In this sense, the new foreign trade system must not emphasize the distribution of export foreign exchange between the central and local authorities, but must emphasize mobilization of all national forces in the development of China's foreign trade undertaking.

By employing a system of a double exchange rate, domestically convertible and not convertible externally, on the condition of not letting it lead to inflation, the domestic market can be closely linked with the international market. Main measures are establishment of a perfect foreign exchange market of a closed pattern, having the exchange rate completely determined by the level of domestic needs of foreign exchange, and allowing speculative long-term trading in foreign exchange. To adjust microeconomic activities so that they will conform to the macroeconomic benefits for the state, the state could interfere openly in the foreign exchange market, having profits and losses of export enterprises completely determined by the foreign exchange market. In concrete operations, the state would establish two foreign exchange markets, overall supervised by the Central Bank, one to be the main foreign exchange market, constituted by the import-export enterprises and the foreign exchange trading centers of the various provinces and municipalities, to be the place where the former settle, buy and sell, and deposit foreign exchange. The other is a short-term foreign exchange market organized by the foreign exchange trading centers of the provinces and municipalities and the state foreign exchange trading center, a market where the state coordinates local exchange rates and where the foreign exchange trading centers of the various provinces and municipalities mutually arrange short-term loans.

As regards export enterprises, the foreign exchange market is a place where they settle foreign exchange, but also trade in foreign exchange. After settling foreign exchange, export enterprises have three alternatives: to sell at the current exchange rate on the exchange market, to sell at a long-term exchange rate to the trading center, or to deposit at official rates of interest with the trading center and obtain a document of exchange settlement from the center, which may later be used in a foreign exchange transaction when needed. As to the import enterprises, they may, after receiving import permits from the government, and holding such documents, join in trading at the trading center. Because import enterprises compute profits in renminbi, they must compare import costs with domestic costs according to the exchange rate of the day, to avoid losses by irrational importing.

Production enterprises are the main force of the export trade. The state should completely delegate all export authority. All production enterprises should be able to apply for registration for the exporting of their products, so that the production enterprises will control the foreign trade enterprises in matters of export. The state should completely cut off administrative and economic relations to foreign trade enterprises, thereby weakening the decisive role of foreign trade enterprises in the current foreign trade structure. All export quotas and permits should be handed out to be auctioned off in the market, and all export promotional measures of a discriminating nature should be abolished, thus establishing a great favorable climate of fair competition for the benefit of the production enterprises.

#### Foreign Investments

With regard to foreign investments, a thorough reform of the foreign investment policy is necessary. First, the state must shift from its current foreign investment policy with its emphasis on foreign exchange to one that focuses on the development of the national economy. On the precondition of waiving the demand for balancing foreign exchange, the state should enact a set of regulations according to the needs of the national economic development with products as a key concern. The determination of the products may take the form of a product catalog. Moreover, other foreign investment policies (such as concerning the examination and approval procedure, encouragement measures, import-export procedures, etc.) must be determined around this product catalog. Its content must, furthermore, be changed according to the changing conditions of the national economy, and it must also be subjected to input-output and optimal performance analyses, thereby ensuring that development of these products will be beneficial for the overall development of the national economy and at the same time will not exceed economic capabilities.

Next, we must effect an organic linkage between foreign trade and foreign investment policy. At present, foreign trade policy, whether with regard to organizational structure or regarding decision-making procedures, is quite



apart from foreign investment policy. Obviously, the key question of combining the two depends on a planned distribution of foreign exchange. Foreign exchange is the only medium by which joint venture enterprises realize the value of their products. Because the entire country's foreign exchange expenditure is a combination of foreign trade import amounts and domestic sales amounts of products of foreign investments (omitting and not figuring other foreign exchange uses), the relationship between foreign trade and foreign investments can be expressed as the cost of interdependent opportunities. However, most major commodities in circulation in China (including foreign exchange) are still subject to compulsory planning, while joint venture enterprises are singularly standing outside the entire economic system, and must therefore effect their own balancing of foreign exchange. For this reason, we must ensure optimal disposition of foreign exchange as used in foreign trade and foreign investments. The theoretical basis here is import substitution, because whatever foreign exchange it saves can be given to foreign investors to remit profits or for reinvestment. In concrete terms, to get rid of the various factors which mutually restrict foreign trade policy and foreign investment policy, one fundamental solution would be to eradicate the source of these factors—to abolish foreign exchange planning, establish a foreign exchange market, and as a consequence combine foreign trade policy and foreign investment policy in one framework. In a mechanism of this nature, joint venture enterprises, the same as domestic enterprises, will be facing the same factors and product market conditions in an environment of fair competition, accept the various economic signals sent through its market by the host country government, and as a consequence effect appropriate investment, production, and sales decisions (including domestic as well as foreign sales), and take in appropriate profits. If enterprises (comprising foreign ventures as well as domestic enterprises) would no longer have to depend on distribution of an administrative nature, but would rely on foreign exchange earned from successful economic activities of the enterprises themselves, direct foreign investments could expect a record-breaking rapid development.

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## AGRICULTURE

### Du Runsheng Discusses Rural Economic Development

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[Article by Du Runsheng [2629 3387 3932], Director of the Rural Policy Research Center of the CPC Central Committee: "Developing the Rural Economy in the Midst of Reform"]

[Text] In 1979 China began to restructure its rural economy, and after 9 years of progress we have achieved notable results. However, overall, China's rural productive forces are still at a rather low level of development and a great many urgent problems remain to be resolved in the process of future rural economic development. Some of these are age-old problems passed down to us from the past, and others are new problems that arose after successful reforms in certain areas. Only if we continue to intensify economic restructuring can we progressively resolve the difficulties that face us and spur China's rural economy to more rapid development.

Below, I will discuss my own views of certain prominent issues in Chinese rural economic restructuring and economic development.

I. China has a population of over 1 billion people, approximately 80 percent of whom live in the countryside. The average per capita income in rural areas is only about 50 percent of what it is in the cities. Thus, the rural populace is still the largest group of low-income people in China. Economic development strategy in the Chinese countryside must combine agricultural development and income improvement into one dual, inseparable objective, and achieve both with one system. Historical experience verifies that no matter what ultimate solution is reached for agricultural problems or peasant concerns, they are closely linked with the accomplishment of our fundamental task of transforming China from a traditional agricultural nation into a modern industrial nation. The two are mutually conducive and mutually restrictive. Consequently, only if we examine agricultural and peasant issues within the sphere of the national economy can we grasp correctly their patterns of development and ascertain the right way to handle them.

II. After we achieved victory in China's new democratic revolution we instituted socialist reforms in agriculture and capitalist industry and entered the initial stage of socialist development. At that time we had no familiar international experience to draw upon in determining how to lead China—a large agricultural nation that had experienced 100 years of suffering, and whose economy had already collapsed—and to establish a modern industrial nation. When China had just begun economic recovery work, we were hit with a blockade on the international market. Under these harsh conditions, China opted for a highly centralized, planned economic system, and chose to assign priority to industrial development, particularly in heavy industry. Through planned pricing and procurement of agricultural goods, we raised the original investment to serve as start-up capital for industrialization. Under the circumstances that existed at the time, this can be considered to have been the only possible choice. During the first 6 or 7 years of the 1950's, because we concentrated fully on readjusting the relationships between industrial and agricultural interests and urban and rural interests, we spurred rapid national economic growth and progressed smoothly along the path toward modernization. But for a long time now national economic development has been focused on industry—particularly heavy industry—and has been biased toward large, state-run enterprises. Industries of this type are characterized by high concentrations of capital, are clustered mainly in urban areas, and have very little capacity to absorb labor and provide employment. Therefore, although by 1978 China had achieved considerable progress in modernization and had constructed its own preliminary system of modern industry, and although industry's share of the GVIAO had risen from 10 percent at the founding of the PRC to 74.4 percent while agriculture's share had fallen from 90

percent to 25.6 percent, there had still been no corresponding change in employment composition. In 1978 the agricultural labor force still comprised 76.1 percent of China's social labor force and the rural population had long been stationary at 80 percent of the total population. Overall population growth and the retention of the large rural population led to a progressive annual decline in per capita holdings of arable land and agricultural resources. Although urban industry grew by leaps and bounds, agricultural labor productivity and peasant incomes grew but slightly. From 1965 to 1977 net income among the peasantry increased at only an average of a little over 1 yuan per year. Thus, for a considerable time the peasantry could not constitute an effective market for industrial goods, nor could it provide enough food and raw materials to support urban and industrial development. When shortages of agricultural products appeared we were forced to adopt policies restricting both population movements between cities and small city development. The use of industrial materials to organize economic activities was essentially reserved for the urban population, and peasants were only able to use agricultural resources to support economic projects. This was a kind of dual structure, in which modern industry and traditional rural agriculture were segregated. The highly centralized collective style under which the people's communes were operated further solidified this structure. Over a period of 20-plus years the exchange of products between urban and rural areas was maintained through the long static system of state pricing for monopoly procurement. This pricing policy put agriculture and the peasantry in an unfavorable position in the economic exchanges between city and countryside and retarded the pace of all rural development. Both in terms of the degree of development of essential material factors for rural modernization, and in terms of the proportion of modern industrial employment, China today lags behind all other developing countries that have GVIO ratios approximately the same as our own. Appraising the urban and rural economy as an organic whole, we must conclude that national industrialization has not, ultimately, been achieved. Therefore, we must examine and correct our economic development strategy. After industrial construction begins to take shape, we should institute economic reforms, knock down the barriers between urban and rural areas, spur the rural labor force to shift toward secondary and tertiary industry, and advance the process of urbanization. Industrial development must not only provide agriculture with larger and larger inputs of modern materials, but, even more important, it must provide more new employment opportunities for the rural labor force. Thus it will establish relationships of mutual economic support and aid between industry and agriculture and between the cities and the countryside. This will help China to progress smoothly from a low-income nation to a middle-income nation.

III. China's rural economic reforms marked the beginning of a new transformation. We began to pursue a series of reform policies in 1979. We significantly

increased agricultural procurement prices and reversed the structural error in the distribution of national income. Then we instituted the output-related system of contract responsibility extensively on public lands, gave peasants managerial autonomy, effectively deployed our own resources, and vastly improved production efficiency. Between 1979 and 1984 the value of agricultural output increased 9 percent per year, per capita grain holdings rose from 637 jin to 790 jin, supplies of agricultural products shot up 24.2 percent, and the long-term shortage of agricultural goods was thus alleviated. We deregulated the labor market and released the surplus labor force that had been frozen in farming. After peasants met their essential living requirements they had some accumulation. This set the stage for economic activities featuring predominantly peasant investment, and it changed the undiversified system of the past, in which the state was nearly the only investor in the industrial sector, to a system of diversified investment. Thereupon, there was a great upsurge in enthusiasm to develop township enterprises in the countryside, and this created multitudinous new employment opportunities as the rural labor force turned more and more toward secondary and tertiary industry. By 1986 the gross value of output from township enterprises had reached 354 billion yuan—or 31.7 percent of the GVIO for that year—and 79 million rural workers were employed in township enterprises—or 61.6 percent as many as were employed in urban jobs.

Rural economic development has also created conditions favorable to urban industrial development. From 1979 to 1984 approximately two-thirds of all new purchasing power came from the peasantry, and the expanding domestic market stimulated supplies of industrial products. During that 5-year period the national GVIO grew at a rate of 8.9 percent per year. This is truly the result of mutual urban and rural cooperation and assistance. This rapid industrial development spurred urban enterprises to evolve toward specialization, and they began to diffuse processed goods, technology, talented personnel, and funding into the countryside. City and countryside allied to establish various jointly operated enterprises and the blockade segregating urban and rural resources was gradually opened up, allowing production elements to begin to circulate. These past few years of experience verify that under the conditions that prevail in China, as far as economic returns are concerned, we must focus both on the internal benefits in individual enterprises and on the overall external benefits in social employment. Only in this way can we ensure coordinated urban and rural development, thus helping to mobilize China's bountiful labor resources and achieve our goal of modernization.

IV. The development of township enterprises restarted the process of urbanization that had been arrested for nearly 30 years. As township enterprises began to concentrate in small cities and towns, they produced a chain reaction which expanded opportunities for employment in tertiary industry. Urbanization helps to break the

geographic limitations of social regions, and it also helps to make enterprise management more independent and to develop lateral links between enterprises. In the past 5 years 23 million rural people have migrated to the cities, and, of these, 3.8 million settlers were farmers responsible for their own subsistence. There are 8,000 new market towns that have arisen. Although these peasants account for a small proportion of the rural labor force, their activities have initiated a preliminary rural labor service market. Right now the developed regions along the eastern coast must absorb several hundred thousand migrant laborers each year into township enterprises and farming. At the same time, these regions export several hundred thousand skilled workers each year to economically underdeveloped regions in the west to engage in various technical and developmental activities. The circulation of labor, technology, and funding creates new combinations of resources, thus improving returns on rural resources.

Because urban and rural areas have long been segregated from each other, under current circumstances if we allow a large part of the rural populace directly into large and medium-sized cities, friction and problems will result and the cause of urban reform will not be helped. In one area of rural industry China is promoting a policy of "leaving the land but not the countryside," while simultaneously concentrating on developing small cities and towns, initiating a smooth transformation of the labor force, accelerating the process of Chinese urbanization, and ensuring a suitable concentration of industries and service trades. Besides, as we intensify reform, it will become historically inevitable for peasants to enter the large and medium-sized cities. Intensifying enterprise reform and allowing enterprises to take responsibility for their own operating profits and losses makes it essential that we reform the current wage system and develop the labor market. Relaxing restrictions on the labor flow between cities and countryside and introducing peasants into the urban labor market not only may effectively balance wage levels based on supply and demand, it may also lead to more reasonable spacing between incomes for simple labor, skilled labor, and complex labor and improve overall labor efficiency in society.

Scarce per-capita agricultural resources in China and an over-concentration of the peasant population onto relatively little arable land has not only caused rural incomes to stagnate at a low level, it has also kept us from increasing agricultural labor productivity and using resources prudently. This will result in ecological and environmental degradation. As of now a labor force of approximately 300 million relies on 100 million-plus hectares of arable land to make a living. This fact reminds us that we must make unremitting, long-term efforts to shift at least 100 million laborers into nonagricultural occupations by the end of this century, and thus help fundamentally resolve China's rural employment problems.

V. That we have improved rural incomes by changing the employment structure does not mean we have solved



agricultural development or resolved the problems of agricultural supply and demand. As secondary and tertiary rural industries have developed, opportunity costs for rural labor have risen and peasant enthusiasm for agriculture, particularly grain production, has inevitably deteriorated. Grain prices are currently depressed and must be increased. The government is now considering what steps must be taken to reach that end. Overall rural production must be guided by the law of value, but we cannot rely only on pricing policies. As industry develops we must press forward with technical reforms in agriculture, increase inputs, and replace extensive farming with intensive farming. Revolving around this requirement is the further need to be realistic and initiate appropriate economies of scale in farming.

The rural economic restructuring that began at the end of the 1970's eradicated the kind of highly concentrated production and centralized distribution that existed under the people's commune system, and instituted the household-based output-related system of contracted responsibility. The real reason that this restructuring raised peasant enthusiasm for production is because it more fully expressed the principle that those who work more, earn more. This produced an enduring stimulus for agricultural production.

However, we must take into account the fact that, because rural employment opportunities were too scarce in the past, the land was the only means of subsistence for peasants. In addition, we are overpopulated and land-poor. When households began contracting it was inevitable that a pattern of per capita land contracting would emerge. Right now each peasant household operates on a scale averaging only about 0.5 hectares. Clearly this decentralized, minuscule scale of farming is very detrimental to technological progress, cost reductions, and improvements in labor productivity. However, neither can we return to the concentrated labor and centralized distribution of the past, because, given the same traditional technology and man-to-land ratio as before, those methods would certainly produce a resurgence of the corruption of "eating out of one big pot." China's scale of agricultural operations depends upon the process of shifting the labor force away from farming. In the past year we have observed that, as there has been considerable development in nonagricultural industry in the countryside, and as 60 percent or so of the labor force has shifted away from farming, there has arisen a demand for a mechanism of application, and a relative concentration of cultivated land has begun to be really feasible. This is because the development of nonagricultural industry has given new economic backing to grass-roots economic organizations. When a large number of peasants who have made the shift are receiving secure incomes, the grass-roots organizations, in their capacity as landowners, can again readjust contracted farmland, including land they have regained or partially regained from peasants who have changed occupations. They can use this land to expand the scale of operations in other

farming households. In the suburbs of some major Chinese cities and in the southeastern coastal regions, these conditions already pertain. We are now setting up test areas in those regions and conducting systematic experiments to provide a scientific basis for formulating policies and laws.

In most parts of China the land is still the chief source of subsistence for area peasants. We cannot just rashly alter land contracting relationships. We must create the appropriate conditions and first develop nonagricultural industries in those regions, and then we must initiate compensated transfers of land-use rights and gradually promote the transfer of labor away from farming. In this process, peasants will own small plots of farmland and will engage simultaneously in all sorts of other commercial production so as to increase cash incomes. Admittedly, this kind of management style has its drawbacks, but it also exists as an objective reality that does not require any particular individual will to change. In these places, during the current phase we should concentrate on social service links, and we should organize, promote the socialization of services, and strive for benefits of scale. We should see to it that when a single family or household cannot manage, or cannot manage well, these kind of service organizations can help with management by promoting advanced technology and lowering costs, can open product sales channels, and can improve economic returns on agriculture. Arable land is a precious resource in China, and decentralized contracting actually to an even greater extent represents a kind of material resource—it accords with the peasants' immediate interests. From a long-term perspective, in order to develop the social forces of production we must focus more on the principle of returns, initiate an appropriate scale of farming, and switch to a high-return method of management. This is indeed a contradiction. We must bring about the conditions necessary to resolve this contradiction.

VI. There are 195 million peasant households in China. This is an extremely populous colony that practices dispersed farming on a minuscule scale. Clearly, the government mechanism cannot directly handle such a large body of farmers. It must institute effective management and provide satisfactory services. At the same time, in the process of establishing market contacts, dispersed, small-scale household farms must both pay exorbitant circulation costs, and also easily cause wide fluctuations in supply and demand. This is detrimental to improving their economic status in market associations. Consequently, we must improve the degree of self-organization while retaining peasant household management.

Prior to rural economic restructuring, through the cooperative movement and the people's commune movement we established an extremely tight system of organization in the Chinese countryside. Nearly all Chinese peasants were part of this system. This system of organization had

one obvious defect—the use of factory methods to organize traditional agricultural production activities. The reliance on administrative forces to interfere inappropriately in management caused producers to lose sight of the direct relationship between their efforts and their incomes. Consequently, it restrained producer enthusiasm for labor and ultimately checked economic vitality within the organizations. Economic restructuring in the countryside has already eliminated this system that blocked commercial economic development. Future economic development in the Chinese countryside must not and cannot return to this old system of organization.

However, it will be no easy thing to establish a welcome, truly cooperative system of economic organization in rural China. This is not only because historically there has been no tradition of cooperative systems in the Chinese countryside, but also because in the previous cooperative movement we adopted some over-extreme, over-hasty measures and inappropriate methods that caused peasants to misunderstand the nature of the cooperative system. The means of eliminating this misunderstanding lies both in establishing long-term stability in rural economic policies and in ensuring that peasants learn from their own experiences in actual economic activities. Consequently, in the current phase we must adopt two basic methods of improving the degree of organization among Chinese peasants. First, now that we have stabilized the output-related system of contracted household responsibility, we must separate government from enterprise and gradually remodel our original collective economic organization, which was based on cooperative land holdings, and transform it into a cooperative economic organization of family farms that provide every kind of production service and engage in integrated management. Second, we must encourage peasants engaged in other rural economic activities to voluntarily establish various new kinds of economic associations at every juncture. Regardless of whether they are cooperative in nature or take the form of partnerships or shareholding systems, whether they are seasonal or long-term and stable, or whether they coordinate the overall operations or only one link between them, so long as these associations help to improve peasant understanding of the necessity of socialized production we must adopt an attitude of encouragement. Right now, the various new forms of economic associations that peasants have voluntarily established in the Chinese countryside reflect both the inevitability that Chinese peasants will develop a cooperative economy based on household farming, and the objective requirement that as they move toward a cooperative system the peasants are certain to undergo a process of self-education. We must understand and act on this inevitability, and we must support the goal of organizing peasants through a cooperative economy. Moreover, we must allow peasants to undergo a process of appraisal so that they will, through self-education, gradually come to recognize the necessity of standardizing the system of organization. We want to develop cooperative rural economic organizations by setting an

example, not by intervening administratively. Simultaneously, in addition to the cooperative system we can ensure that dispersed household operations get on course toward organization through the organized activities of various kinds of large-scale agricultural technology and service organizations and agricultural processing and marketing enterprises.

The establishment of the output-related system of contracted responsibility based on household management has created a new starting point for using various means to improve the degree of organization among Chinese peasants. But this is still merely a starting point. We must not stop there but, instead, working from the objective demands and peasant aspirations that arise from rural economic development, we must strive to engage in all sorts of activities that will help to improve the degree of peasant organization. Even though this will be a very lengthy process, we absolutely must not abandon the task before us.

VII. As far as supplies of agricultural goods are concerned, people are most concerned about grain. In grain production, we must say that China has already attained the production capacity necessary to ensure that, overall, people have enough to eat. According to a survey conducted by the Nutrition Institute of the Chinese Academy of Medical Sciences, in 1982 2,485 kilocalories per capita per day were absorbed from the average diet in China. This level is 5.7 percent higher than the average for developing countries, and is 0.2 percent higher than the Physiological Institute's recommendation. In the future, as our population continues to increase, grain supplies must, of course, also continue to rise. We feel there is potential for grain production in China. From 1979 to 1984 per-mu grain production in China increased 72.5 kg, an average of 12 kg per year. If we figure our average per capita grain holdings at 400 kg in the year 2000, and if we consider that grain growing area will continue to decline somewhat each year, in the next 12 years we must increase our per-mu yield nearly another 6 kg per year. Almost two-thirds of existing cultivated land is low-yield land, and another nearly 100 million mu is reclaimable wasteland. If we improve, prepare, and develop these fields by turn, we can satisfy the increase in demand. But in order to meet this requirement, we must increase inputs. State investment is essential, but the biggest responsibility lies with the peasantry. The prerequisite is that we must help them to farm with enthusiasm. Thus we must establish a suitable policy environment for them, or else the potential for increased output will remain unrealized. The price factor is crucial in this respect. Right now a considerable portion of the grain we procure is cheap. If peasants feel that it doesn't pay to produce grain, they will direct their input of resources into other areas and switch to production that brings high returns. The state must institute a suitable price guarantee policy for grain production.

As far as grain consumption is concerned, the new situation we are facing is that people now want to eat well rather than to merely satisfy their hunger. Simply

put, in the future the increased use of grain for fodder and for brewing and distilling will make this the major growth trend in grain consumption. Now that people have enough to eat, if we allow the consumption of grain for fodder and for brewing and distilling to grow unimpeded, it will be hard to satisfy the demand even if we produce 1,000 kg of grain per capita, much less 400 kg per capita. Obviously, this exceeds China's grain supply capacity. Consequently, we must assert some guidance over diet and consumption. An effective means of guidance is achieved through appropriate pricing policies. We must see to it that grain prices both encourage production and guide consumption. However, today's pricing system both depresses grain production and stimulates consumption. The prices of food products sold in Chinese cities are heavily subsidized. At the same time, because of our current welfare system, it is possible for urban residents to consume an overly narrow range of foods. As a result, as urban incomes increase residents direct their purchasing power toward non-staple foods. We must gradually reform this situation—the food marketing system and the overall wage and welfare system. On the one hand, we must formulate reasonable procurement policies, and on the other hand we must change the system of overall price subsidies for urban residents to a system of welfare aid for low-income people. We must balance supply and demand by means of market pricing. Reverting to an overall monopoly procurement system when grain is in short supply can only lead to even greater shortages. Many years of experience proves that there can be no other outcome. Consequently, we must resolutely and cautiously institute a circulation system directed toward establishing market regulation under the control of the state plan.

In sum, with respect to the grain issue, our persistent goal is to develop production and guarantee supplies on the domestic front, but at the same time not to exclude limited use of the international market to adjust varieties and annual surpluses and deficits. We must guarantee that the people have enough to eat and that low-income individuals receive steady supplies, and, as far as possible, we must also allow people to eat well. But we do not plan to sacrifice the many other goals of social economic development to do so.

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### Hebei Wheat Storage

40060426e Shijiazhuang HEBEI RIBAO in Chinese  
24 Jun 88 p 1

[Excerpt] As of 23 June, Hebei Province had put 152,400,000 kilograms of wheat in storage.

### Shaanxi Cotton Area

40060434a Beijing JINGJI CANKAO in Chinese  
23 Jun 88 p 2

[Excerpt] This year Shaanxi Province has sown 1.1 million mu to cotton, a 23 percent increase over 1987.

### Shandong Peasant Income

SK3107035188 Jinan Shandong Provincial Service in  
Mandarin 2200 GMT 29 Jul 88

[Excerpts] According to sample investigation data compiled during the first half of this year, Shandong Province's per peasant income, excluding that earned from saving deposits and loans, was 236.68 yuan, a 30.5 percent increase over the corresponding period in 1987. Major reasons for this increase are that peasants increased their income by selling their farm products and animal by-products with the advantage of price readjustment, and that they increased their income through labor by operating household-run tertiary industry. What merits our attention is that the scale of income increase scored by peasants during the first half in operating town-run enterprises was low.

### New Fine Quality Soybean Parent Stock Bred in Heilongjiang

40110023A Harbin HEILONGJIANG KEXUE  
[HEILONGJIANG AGRICULTURAL SCIENCE] in  
Chinese No 1, 10 Jan 88 pp 8-11

[Article by Zhang Guodong [1728 0948 2767], Soybean Research Institute, Heilongjiang Provincial Academy of Agricultural Sciences: "New Fine Quality Soybean Parent Stock Bred in Heilongjiang Province"]

[Abstract] Most of the soybean varieties grown in Heilongjiang Province since the founding of the People's Republic have derived from just four basic parent pairs and two mainstay parent pairs. These varieties have been used to screen out other mainstay varieties and to produce hybrids. Consequently, there is too close a genetic relationship among various soybean lines, which makes all soybeans pretty much alike. Work begun in the early 1970's on the production of new hybrids from geographically distant genes has begun to pay off in the 1980's. 12 of the 37 soybean hybrids approved for promotion in the province during the 1980's containing lines introduced from outside China.

Much of this 3-1/2 page article is devoted to an explanation of the lines used to create new hybrids: such as Hefeng No 5, Heihe No 3, Fengshou No 10, and Heihe No 54, as well as the value of a Japanese variety now known as Shisheng Changye in improving local varieties. The article also reports advantages gained from the new hybrids including super early ripening (a valued trait in this northernmost province), increased fat or protein content, new advances against gray speck disease, and enrichment of the soybean gene pool.

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**Detection Results of Varieties Resistant to Rice Blast by Single Gene**

40110023B Harbin HEILONGJIANG KEXUE  
[HEILONGJIANG AGRICULTURAL SCIENCE] in  
Chinese No 1, 10 Jan 88 pp 12-16

[Article by Lo Guiru [5012 2710 5423], Yang Liquan [2799 4539 5028], and Shang Shiji [0794 0013 0679], Mudanjiang Agricultural Research Institute, Heilongjiang Provincial Academy of Sciences: "Results of the Use of Monogenic Detector Varieties in Testing Rice Blast Bacteria Microspecies"]

[Abstract] Results obtained from research conducted from 1983 through 1986 in Heilongjiang Province on physiological microspecies of rice blast bacteria are reported in this article. Twelve japonica rice detector varieties from Kiyozawa, Japan were used in this research. Use of the monogenic Japanese variety was necessitated by the discovery that most Chinese varieties used for detection were bigenic or polygenic, making them virtually useless in detecting pathogenic microspecies of rice blast bacteria. Some Chinese varieties of indica rice were also used. The microspecies were divided into pathogenic types on the basis of their pathogenicity for detector varieties known to possess resistant genes, and the area of distribution of the microspecies as well as the utility of known resistant genes in Heilongjiang Province were charted. In addition, reasons for the loss of resistance to rice blast of some formerly resistant varieties were explored. This

data is intended to serve as a basis for the breeding of resistant varieties, for the importation from abroad of resistant varieties, and for the promotion of resistant varieties throughout the province.

This four page article provides very detailed data about materials and methods used in the research, and about the results obtained. Most of the results are reported in four easy to understand tables.

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**Beijing Duck Deaths Traced to Biotin Poisoning**

Beijing ZHONGGUO SHOUYI ZAZHI [CHINESE  
JOURNAL OF VETERINARY MEDICINE] in Chinese  
No 2, 22 Feb 88 pp 21-22

[Article by Guo Yupu [6753 3768 3877] and Tian Kegong [3944 0344 1872]: "Biotin Toxicosis of Beijing Ducks"]

[Abstract] The death of flocks of ducks at two farms in Beijing's suburbs during the summer of 1986 was ultimately traced to Type C biotin poisoning attributed to rotten meat in water to which the ducks had free access. This very brief article explains the serological tests performed on white mice to identify the toxin, and offers suggestions on how to guard ducks against similar poisoning.

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GONGHEGUO GUOWUYUAN GONGBAO [PRC  
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[Text] 1. PRC Regulations on the Prevention of Pneumoconiosis (Promulgated by the State Council on 3 December 1987) [Not translated]

2. Measures Governing Narcotics Control (Promulgated by the State Council on 28 November 1987)

3. State Council Circular on Further Stepping Up the Work on Cultural Relics (24 November 1987) [Not translated]

4. State Council Circular on Salary Increase for Teachers of Primary and Middle Schools (28 November 1987) [Not translated]

5. State Council Announcement (5 December 1987) [Not translated]

6. Acting Premier Li Peng's Address at the Closing Ceremony of the Sixth National Games (5 December 1987) (Text: CHI-87-234, 7 Dec 87, p 26)

7. Acting Premier Li Peng's Address at the Opening Ceremony of the 21st Century Committee for China-Japan Friendship (30 November 1987) (Summary: CHI-87-229, 30 Nov 87, p 7)

8. Acting Premier Li Peng's Message to the Meeting Marking the "International Day of Solidarity With the Palestinian People" (30 November 1987) (Summary: CHI-87-229, p 8)

9. Bulletin of the Leading Group for Sample Census of the Handicapped and the PRC State Statistics Bureau on the Major Statistics of a National Sample Census of the Handicapped (Issued on 7 December 1987) [Not translated]

10. Commerce Ministry Circular on the Promulgation of the "Provisional Rules on Economic Contracts of Commercial Departments" (1 September 1987)

11. Provisional Rules on Economic Contracts of Commercial Departments

12. State Council Approval of Hubei Provincial People's Government Request To Abolish Anlu County and Establish Anlu City (4 September 1987) [Not translated]

13. State Council Approval of Guangdong Provincial People's Government Request To Readjust the Administrative Division of the Xuande Island and Qiliangyu Area in the South China Sea (10 September 1987) [Not translated]

14. PRC Presidential Appointments and Removals (3 December 1987) [Not translated]

15. State Council Appointments and Removals (13 April, 1 July, 30 October 1987) [Not translated]

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**Rules on Narcotics Control**  
40050303b Beijing ZHONGHUA RENMIN  
GONGHEGUO GUOWUYUAN GONGBAO [PRC  
STATE COUNCIL BULLETIN] in Chinese  
No 28, 15 Dec 87 pp 918-923

[Measures Governing the Control of Narcotics (Promulgated by the State Council on 28 November 1987)]

[Text]

**Chapter 1: General Provisions**

Article 1: In order to strictly control narcotics and ensure their safe use for medicinal, educational and scientific research purposes, the present Measures have been formulated, pursuant to the provisions of the "PRC Law on the Control of Medicinal Substances."

Article 2: The term "narcotics" refers to medicinal substances which after continuous use are apt to cause dependence and to become addictive.

Article 3: Narcotics comprise the opium group, cocaine group, marijuana group, compound narcotics, and other medicinal substances which the Ministry of Health shall designate as addictive, as well as plants they are derived from and their preparations.

Article 4: State control extends to the growing of plants from which narcotics are derived, as well as to the production, supply, import and export of narcotics; the use of all narcotics is forbidden, unless for medicinal, educational, or scientific research purposes.

**Chapter 2: Planting and Production of Narcotics**

Article 5: Units which intend to grow plants from which narcotics are derived must obtain approval from the Ministry of Health as well as from the Ministry of Agriculture, Animal Husbandry, and Fishery and the State Medicine Control Bureau, with a copy of the approval to be sent to the Ministry of Public Security.

Units who intend to produce narcotics must apply for examination and approval to the Ministry of Health and the State Medicine Control Bureau. Without approval, no unit or individual is permitted to engage in the production of narcotics.

Article 6: The annual plan for the growing of plants from which narcotics are derived must be approved by the Ministry of Health and the Ministry of Agriculture,

Animal Husbandry, and Fishery, while the annual plan for the production of narcotics must be approved by the Ministry of Health and the State Medicine Control Bureau; both these agencies shall jointly transmit the approved plans to the applicants to be carried out. Units which have obtained the above mentioned approvals to grow or produce are not permitted to willfully alter the plans. Growing or producing units must designate particular persons to be responsible for the end-products, semifinished products, and poppy capsules and seeds, custody of which shall be strictly controlled, and the sale and use of which by the units themselves is strictly forbidden.

Article 7: Quality control in the production of narcotics must be enhanced; the quality of products must be up to national medicinal standards.

Article 8: Research and trial production of new narcotics may only be started after a production plan, to be prepared by the producing unit, shall have been assessed and approved by the Ministry of Health. On completion of research and trial production, the "Measures for Examination and Approval of New Medicines" shall apply, and procedures for custody and use shall be strictly observed, to guard against loss of production secrets.

### Chapter 3: Supply of Narcotics

Article 9: Narcotics shall be supplied in a planned manner as needed in medicine, teaching, and scientific research. The plan for nationwide narcotics supplies must be submitted by a department to be designated by the State Medicine Control Bureau. The plan must be submitted to the Ministry of Health and the State Medicine Control Bureau for examination and approval, after which it shall be made known to the lower agencies for execution.

Article 10: Setting up units for trading in narcotics shall be reported by the public health departments and the medicine control departments of the provinces, autonomous regions, and centrally administered municipalities to the Ministry of Health and the State Medicine Control Bureau for examination and approval. Units trading in narcotics may supply prescribed quantities only to narcotics using departments approved by the health administration agencies and to no other unit or individual.

Article 11: The supply of poppy capsules for the manufacture of narcotics is to be handled by business units designated by the State Medicine Control Bureau and the medicine control departments of the various provinces, autonomous regions, and centrally administered municipalities; no other unit may engage in this trade. Poppy capsules have to be allocated and distributed according to a plan which has to be jointly examined and approved by the Ministry of Health and the State Medicine Control Bureau. Poppy capsules may be used by medical units in making up prescriptions and if supplied

by business units designated by the health departments of county or higher ranking administrations on the strength of a prescription signed by a doctor's office holding the official seal of health practitioner, but must not be sold separately. Plans of medicine manufacturing enterprises which need poppy capsules in their preparations must be examined and checked by the medicine control department of the province, autonomous region, or centrally administered municipality where the enterprises are located, and these shall then submit the plan to the health administration for checking and approval, after which the plan shall be returned to the applicant for execution.

Article 12: All units trading in narcotics must have special storage rooms or cupboards suitable for the storage of narcotics, and must designate particular persons to be responsible for the storage, transportation, and supply of narcotics.

### Chapter 4: Transportation of Narcotics

Article 13: Transportation of opium for medicinal purposes must complete the procedure of obtaining a domestic transport permit issued by the Ministry of Health. When a unit which has grown opium plants is shipping opium for medicinal purposes to the warehouse of the State Medicine Control Bureau, the dispatching unit shall have someone accompany the shipments. For shipments from the warehouse to the medicine manufacturing unit, the receiving unit shall send someone to accompany the shipments. The number of accompanying personnel shall be regulated by the transporting unit.

Transport permit forms will be unifiedly printed by the Ministry of Health.

Article 14: When shipping narcotics and poppy capsules, apart from shipments of opium for medicinal purposes, the producing unit and the supplying unit must clearly mark the cargo as "narcotics" in the column for the description of the shipment on the waybill, and in the column "consignor's remarks" consignor shall stamp the waybill with a stamp inscribed "special narcotics stamp." Shipment may then go forward after completion of these formalities.

Article 15: When accepting narcotics or poppy capsules for shipment, the transport unit must give it added care and promptly effect shipment, reducing the time of storage at railway stations, wharfs, and airports. The railway must not use open freight cars. For highway transportation the cargo must be firmly covered and secured with tarpaulins.

Article 16: In case of any in transit loss, the transport unit must thoroughly check and search, and immediately report to the local public security organs and the public health departments to institute an investigation.



### Chapter 5: Import and Export of Narcotics

Article 17: Imports and exports of narcotics shall be handled by the unit designated by the Ministry of Foreign Economic Relations and Trade according to the state's foreign trade provisions; no other unit may import and export narcotics. Annual plans for the import and export of narcotics must be submitted to the Ministry of Health for examination and approval.

Article 18: Whenever narcotics have to be imported for medicinal, educational, or scientific research purposes, an application has to be submitted to the Ministry of Health for examination and approval; import procedure may only be started after receipt of a "narcotics import permit" from the Ministry of Health.

Article 19: Whenever narcotics are to be exported, an application shall be submitted to the Ministry of Health, together with an import permit made out by the authority in charge in the importing country; export procedure may only be started after receipt of the "narcotics export permit" from the Ministry of Health.

Article 20: Import and export permit forms shall be unified printed by the Ministry of Health.

### Chapter 6: Use of Narcotics

Article 21: Narcotics may only be used for medicinal, educational, or scientific research purposes. Medical units that have sickbed facilities and undertake operations, or that have certain facilities to perform medical techniques, may apply to the local administration in charge of public health. After approval of the request by the higher ranking public health administration, and its check and determination of the grade of eligibility for supplies, the unit may be issued a "narcotics purchase and use card with seal impression." The said unit may then buy the narcotics from a designated narcotics trading unit according to the provisions governing the limits of narcotics to be bought and used.

Units in need of narcotics for educational or scientific research purposes shall apply to the health administration directly superior to their local health administration, and on receipt of its approval may buy the narcotics from the narcotics trading unit.

Norms for grading units for eligibility for limited quantities shall be determined by the Ministry of Health.

Article 22: When buying narcotics, the narcotics using unit must complete and submit to the narcotics trading unit a "list of narcotics bought." When supplying narcotics, the narcotics trading unit must carefully check the various seals and quantities. The quantities supplied must be of the types prescribed by the Ministry of Health and must be supplied according to the provisions governing quarterly limits for purchase and use.

Article 23: When purchasing its supplies, the narcotics using unit may buy not only directly from the narcotics trading units, but also by mail; all documents and permits must be sent by registered mail. On parcels of narcotics sent through the mail, the narcotics trading unit shall impress its "special seal for narcotics" stamp and shall make out an invoice, stamped with the "special seal for narcotics," as evidence of having properly dispatched the goods through the post office.

Article 24: All preparations that fall within the scope of narcotics must be bought through the narcotics trading units. Where such preparations are not available within a certain jurisdiction or in case a medical unit has special need for such preparation, a medical unit which is authorized to use narcotics may itself make up the preparation after obtaining approval from a medical administration of county or higher rank, but no other unit is permitted to make up such preparations by itself.

Article 25: Medical personnel are permitted to use narcotics only if they perform the duties of doctors or of higher qualified specialists and have been checked out as capable of accurately applying narcotics.

Medical personnel carrying out operations in execution of family planning, who have been checked out as capable of accurately using narcotics, are authorized to write out prescriptions for narcotics.

Article 26: Prescriptions for injected narcotics must not be for more than 2 days of regular supplies; for narcotics in tablet, tincture, or syrup form, prescriptions must not be for more than 3 days of regular supplies, and continued use must never exceed 7 days. Prescriptions for narcotics must be written out completely in clear letters and signed by the prescribing physician. The person who makes up the prescription must carefully check it. This person as well as a control person must both sign the prescription. A register of narcotics has to be kept. Medical staff are not permitted to prescribe narcotics for themselves.

Article 27: Critically ill persons, who have been diagnosed as such by a medical unit of county or higher rank and who truly need narcotics to kill pain, may be issued a "special narcotics use card" on the strength of the medical examination certificate made out by a medical unit designated by a medical administration of county or higher rank, as well as by producing their census record. With the special narcotics use card, the patient may have his narcotics made up according to regulations by the designated medical unit. If medical units find their quarterly supplies insufficient due to an increase of patients holding "special narcotics use cards," they may have their supplies increased on approval by the medical administration directly superior to their local medical administration.

Article 28: Medical unit must tighten control of narcotics. It is forbidden to illegally use, store, transmit, or loan narcotics. Medical units shall designate particular persons to be responsible. The units must have special locked cupboards, keep special accounts, use special prescriptions, have special registers, and keep prescription records for 3 years for possible checking. Medical units are authorized to refuse further supplies of medicines to places who violate regulations and indiscriminately use narcotics; they must promptly report such cases to the local health administration.

Article 29: When narcotics are urgently needed in emergency cases to save the life of a patient, the medical unit and the narcotics trading unit in question may immediately take quick action, but limited to one dose in each case; incomplete procedures may be made up later.

#### Chapter 7: Penalty Clauses

Article 30: In case of any of the following violations of the present Measures, the local medical administration may confiscate all narcotics and illegal gains and impose a penalty of from 5 to 10 times the amount of the illegal gains, or close the business, order readjustment, or revoke the "medical products manufacturing enterprise license," "medical products trading enterprise license," or the "permit to make up prescriptions," depending on the severity of the cases:

- (1) Unauthorized narcotics production, change of narcotics production plans, or unauthorized increase of types of narcotics;
- (2) Unauthorized trading in narcotics or poppy capsules;
- (3) Supplying narcotics to units or individuals not approved to receive narcotics, or supplying in excess of permitted limits;
- (4) Unauthorized making up and selling narcotics preparations;
- (5) Unauthorized imports or exports of narcotics;
- (6) Unauthorized application of new narcotic medicines on patients, production of new narcotics before obtaining approval.

Article 31: Personnel directly responsible for taking advantage of their working place facilities by prescribing for others contrary to the requirements of regulations, or any persons who prescribe for themselves, obtain narcotics by fraud, or indiscriminately use narcotics are to suffer administrative sanctions imposed by their local units.

Article 32: Those who violate the present Measures by the unauthorized growing of poppies, or illegally take narcotics, shall have sanctions imposed by the public

security organs according to the "Regulations on Penalties in Connection With the Control of Public Security" or other relevant regulations.

Article 33: Whenever the production, transport, and sale of narcotics or poppy capsules in violation of the present Measures constitute criminal offences, the judicial organs shall institute investigations as to criminal responsibilities.

Article 34: Anyone who refuses to accept the administrative penalty may within 15 days of receiving the penalty decision request a review by the administrative agency directly superior to the one that imposed the penalty. The said higher authority shall reply within 10 days of receipt of the request for review. If still dissatisfied with the review decision, a suit may be filed in the people's court within 15 days of receipt of the review decision. If no suit is filed within prescribed time limits by the party dissatisfied with the penalty decision, the organ which had issued the original penalty decision may request the people's court for compulsory execution.

#### Chapter 8: Supplementary Provisions

Article 35: For the supply and use of narcotics by the health and medical units of the armed forces and gendarmery, the Ministry of Health together with the general logistics department of the PLA and of the Chinese People's Gendarmery shall formulate specific regulations in line with the present Measures.

Article 36: For the supply and use of narcotics for animals, the Ministry of Health and the Ministry of Agriculture, Animal Husbandry, and Fishery shall formulate specific regulations in line with the present Measures.

Article 37: Detailed rules for the implementation of the present Measures shall be determined by the Ministry of Health.

Article 38: The present Measures shall come into force on the day of their promulgation. The "Regulations Governing the Control of Narcotics," promulgated by the State Council on 13 September 1978, shall cease to be in force on the same day.

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#### Commerce Ministry Circular Promulgating Rules on Economic Contracts

40050303c Beijing ZHONGHUA RENMIN  
GONGHEGUO GUOWUYUAN GONGBAO [PRC  
STATE COUNCIL BULLETIN] in Chinese  
No 28, 15 Dec 87, p 937

[Commerce Ministry Circular on the Promulgation of the "Provisional Rules on Economic Contracts of Commercial Departments" (1 September 1987) (Reference "shangban" (1987) No 10)]

[Text] To enhance the administration of economic contracts by commercial departments, and pursuant to the "Foreign Economic Contract Law of the PRC," the

"Provisional Rules on Economic Contracts of Commercial Departments" have been formulated. The text of the Rules is herewith published, with the request that they be conscientiously implemented on trial. Any problem that may arise during trial implementation, please immediately report to the general office of this Ministry, so that they may be considered when the Rules will be amended.

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40050304a Beijing ZHONGHUA RENMIN  
GONGHEGUO GUOWUYUAN GONGBAO [PRC  
STATE COUNCIL] in Chinese No 1, 30 Jan 88 pp 1-2

[Text] 1. Acting Premier Li Peng's Congratulatory Speech at a New Year Tea Party Given by the CPPCC National Committee (1 January 1988) (Text: CHI-88-001, p 22)

2. State Council Circular on the Policy of Perfecting the "Three Link-Ups" System of Contracted Grain Purchase (3 January 1988)

3. State Council Circular on the Promulgation of the "Provisional Regulations on the Control of Price Ceilings for Important Means of Production, Communications, and Transport" and the "Provisional Regulations on the Control of National Unified Price Ceilings for Production Materials Outside the State Plan" (11 January 1988)

4. Provisional Regulations on the Control of Price Ceilings for Important Means of Production, Communications, and Transport (Promulgated by the State Council on 11 January 1988) (Summary: CHI-88-013, p 23)

5. Provisional Regulations on the Control of National Unified Price Ceilings for Production Materials Outside the State Plan (Promulgated by the State Council on 11 January 1988) (CHI-88-016, p 25)

6. State Council Circular on the Approval and Transmittal of the Provisional Regulations of the State Planning Commission on the Collection of Electric Power Construction Charges (21 December 1987) [Not translated]

7. Provisional Regulations on the Collection of Electric Power Construction Charges [Not translated]

8. Circular by the State Council General Office on Transmittal of the Minutes of the Conference on the Study of Agricultural Development on the Sanjiang Plain, Heilongjiang Province (28 December 1987) [Not translated]

9. Minutes of the Conference on the Study of Agricultural Development on the Sanjiang Plain, Heilongjiang Province [Not translated]

10. Provisional Rules on the Registration of Prospecting and Extraction of Petroleum and Natural Gas (Approved by the State Council on 16 December 1987) [Not translated]

11. Rules on the Contribution of Capital in Sino-Foreign Joint Ventures (Promulgated by the State Council on 30 December 1987) [Not translated]

12. Circular by the Ministry of Public Health, the Ministry of Foreign Affairs, the Ministry of Public Security, the State Education Commission, the National Tourism Administration, the Civil Aviation Administration of China, and the State Bureau of Foreign Experts Affairs on Promulgation of the "Provisional Regulations on the Monitoring and Control of AIDS" (14 January 1988) [Not translated]

13. Provisional Regulations on the Monitoring and Control of AIDS (Approved by the State Council on 26 December 1987) [Not translated]

14. Rules by the State Scientific and Technological Commission on the Assessment of Scientific and Technological Achievements (Promulgated by the State Scientific and Technological Commission on 26 October 1987) [Not translated]

15. Circular by the State Bureau of Archives and the State Council Legislation Bureau on Implementation of the "PRC Archives Law" 17 December 1987) [Not translated]

16. State Council Approval of Jiangsu Provincial People's Government Request To Abolish Suqian County and Establish Suqian City (15 December 1987) [Not translated]

17. State Council Approval of Jiangsu Provincial People's Government Request To Abolish Danyang County and Establish Danyang City (15 December 1987) [Not translated]

18. State Council Approval of Jiangsu Provincial People's Government Request To Abolish Dongtai County and Establish Dongtai City (17 December 1987) [Not translated]

19. State Council Approval of Fujian Provincial People's Government Request To Abolish Shishi County and Establish Shishi City (17 December 1987) [Not translated]

20. State Council Approval of Jiangsu Provincial People's Government Request To Abolish Xinghua County and Establish Xinghua City (22 December 1987) [Not translated]

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**'Three Link-Ups' System of Contracted Grain Purchase**

40050304b Beijing ZHONGHUA RENMIN GONGHEGUO GUOWUYUAN GONGBAO [PRC STATE COUNCIL BULLETIN] in Chinese  
No 1, 30 Jan 88, pp 5-6

[State Council Circular on the Policy of Perfecting the "Three Link-Ups" System of Contracted Grain Purchase (3 Jan 1988) [State Council issue No 1 (1988)]]

[Text] The policy of the "three link-ups," observed during 1987, namely to link grain procurement contracts with parity prices for chemical fertilizer and diesel oil, and paying down payments for advance purchases, was energetically carried out by the people's governments and the departments in charge and was well implemented in most localities. It inspired the enthusiasm of the peasants for grain production and grain sales. However, many places reported that there was confusion in methods, and that a few places had the problems of link-up materials and funds for advance down payments being withheld, embezzled, or diverted to other uses, which incensed the peasants. The State Council has therefore decided to continue the "three link-ups" policy in 1988, but to change and improve the specific methods of implementation, and also to improve the cash payment part of it. Following are the problems involved:

1. In 1988, the central authorities will allocate chemical fertilizer, diesel oil, and funds for advance down payments to all provinces, autonomous regions, and centrally administered municipalities according to the distribution of contracted procurement tasks for grain and according to the link-up norms, and have said administrative units assume responsibility for their proper use. All provinces, autonomous regions, and centrally administered municipalities shall simplify procedures, make things convenient for the people, and act on the principle that the material benefits of the "three link-ups" policy shall reach down to the peasants who sell grain. The said administrative units shall formulate substantial and feasible methods, based on conscientiously reviewed experiences of the past and attuned to the actual conditions of the places in question, to ensure effective implementation of the "three link-ups" policy.

2. In 1988, the central authorities will allocate contractual procurement tasks to all provinces, autonomous regions, and centrally administered municipalities unchanged to a total of 50 billion kilos. To make up for crop failures at times of bumper harvests and to ensure fulfillment of the contractual procurement tasks, provinces, autonomous regions, and centrally administered municipalities may increase the emergency grain figure by a small amount (a maximum of 10 percent), and may also subdivide the emergency grain figure, so as to be used by the province, its prefectures, and its counties. No other quotas increases at the various levels shall be allowed anywhere.

3. The allotments by the central authorities of chemical fertilizer and diesel oil linked with contractual procurement of grain shall remain unchanged at last year's amounts. To make sure that the commitment of the

"three link-ups" policy will be honored, chemical fertilizer needed due to increases in the emergency figures of provinces, autonomous regions, and centrally administered municipalities will be taken care of by the central authorities, while the provinces, autonomous regions, and centrally administered municipalities shall themselves take care of diesel oil required for this purpose.

4. Chemical fertilizer and diesel oil linked with the contractual procurement of grain shall be supplied at 1987 prices. In order to protect the benefits to the peasants, it is strictly forbidden to raise prices in disguised ways or to interpose any exploitative methods.

5. Chemical fertilizer and diesel oil linked with the contractual procurement of grain will again be supplied by stages and in groups. In order not to miss the proper farming seasons, all localities when signing grain procurement contracts with the peasants shall, according to the resources of the places in question, supply in advance a part of the link-up materials. The chemical fertilizer that should be allocated this year by the central authorities has already been supplied to 15 percent in the fourth quarter of last year to all provinces, autonomous regions, and centrally administered municipalities, and 35 percent shall be allocated in the first quarter of this year. Diesel oil for this year's link-ups is still being supplied in equal parts every quarter.

6. Down payment for grain shall be paid at the time of signing the procurement contracts at the rate of 20 percent of the total value of grain to be supplied under the procurement contract, and shall be subtracted when the peasants deliver the grain, while interests will be borne by the central financial authorities. In areas of well developed economies, where peasants are not in need of cash, or where obligations under contract are limited so that peasants do not want to take down payments, there would be no need to make such down payments. If no down payments are made throughout one county, prefecture or city, this fact shall be reported to the people's government of higher rank for their approval.

7. To stimulate greater enthusiasm among the peasants for grain production, people's governments in all provinces, autonomous regions, and centrally administered municipalities shall, as early as possible, publicize the "three link-ups" policy, its norms and its method of implementation among the peasants, and also institute a responsibility system by ranks and by departments, to truly make a success of the system. Any unit or person guilty of retaining, embezzling, privately distributing, or diverting link-up materials or funds for advance down payments shall be severely dealt with according to the provisions of the "Urgent State Council Circular on the Determined Implementation of the 'Three Link-Ups' Policy in the Contractual Procurement of Grain." [State Council issue No 60 (1987)]

Note: For the "Urgent State Council Circular on the Determined Implementation of the 'Three Link-Ups' Policy in the Contractual Procurement of Grain" see issue No 18 (1987) of this publication.

### Comparison of U.S., Soviet Naval Operations Theory

40050265 Beijing GUOFANG DAXUE XUEBAO  
[NATIONAL DEFENSE UNIVERSITY JOURNAL] in  
Chinese No 12, 1 Dec 87 pp 78-80

[Article by Lei Huajian [7191 5478 1696], Instructor, Office of Military Service Arms Education and Research: "Comparison of the Main Themes in the Study of American and Soviet Naval Operations Theory"]

[Text] The matters that attract most attention in the study of trends in American and Soviet naval operations theory are the American navy's discussion of "naval mobile warfare" theory, and the Soviet navy's emphasis on the principle of "surprise." One might say that they are main themes in current study of American and Soviet naval operations theory, and that they reflect the basic situation in future American and Soviet naval operations.

For convenience in making comparisons, let me first explain briefly naval mobile warfare theory and the principle of surprise.

At the end of the 1970's, first the United States army and then the navy began to study mobile warfare theory. This was a major change in American combat theory. In the course of this change in theory, the United States Army produced the theory of "Air-Land Integrated Battle," which was developed along the lines of the "observe, determine, decide, and act" cycle (the "OODA" cycle) proposed by United States Department of Defense advisor, John Boyd, USAF, retired, which gradually was fashioned into a theory for naval mobile warfare.

The principle underlying naval mobile warfare theory is that in the combat process, all movements proceed in a definite cycle that goes from observation, to determination, to decision, to action. If any of the links in this cycle is blocked, the cycle has to either begin all over again or be extended. If blocked continuously, the cycle becomes chaotic, resulting in the enemy being placed in a position of jumping from one decision to another, being unable to carry out plans, and naval formations being unable to synchronize their activities, a situation that enables the American navy to "strike first to control the enemy" and to "destroy the enemy one by one," winning time and making opportunities. Clearly, such mobile naval warfare is a unique form of warfare, not the mobile warfare of maneuvering naval vessels in the usual sense. Its essence is to harass, to confuse, or to baffle the enemy, and to destroy his internal communications in order for "small forces to gain dominance over large forces" using the "elements of surprise, psychological shock, and the position and finely honed forces one has" to obtain "the results that are produced only when the enemy has been enticed into making mistakes" of which Clausewitz spoke. The core of this theory is to attain victory through

stratagems; consequently it carries some risk. This theory and the army's "Air-Land Integrated Battle" theory (the army's theory for mobile warfare) are in the same category. Their basic ideas place stress on "paralyzing the enemy," "not allowing the enemy opportunities to bring his troops into play," and "small forces winning victory over large forces." The two theories' point of difference is that the Air-Land Integrated Battle stresses hard methods for inflicting casualties such as "deep strikes," and "three dimensional interdiction," while the emphasis in naval mobile warfare is on a combination of lethal and non-lethal methods for inflicting casualties. When the two are compared, results from the latter seem difficult to judge, and it seems not as well-founded as the former. However, in view of the realities of naval warfare, and inasmuch as the ability of both sides to use the most advanced weaponry, the American Navy's espousal of such a theory must make people ponder. One might say that this is a high technology warfare theory. Its role has appeared in sea and air actions such as the United States surprise attack against Libya and the landings in Grenada.

Everyone knows the Soviet navy's principle of "surprise," so it will not be explained again here. The point to be emphasized is how surprise is understood. Usually it is explained as surprise in terms of time, place, and tactics. This means that the choice of time, place, and tactics will be a surprise as far as the enemy is concerned. However, under conditions of modern warfare, movements within the operational area can trigger observation by highly sensitive, and highly discriminating electronic devices. It is very difficult to take any actions that leave no traces. Therefore, new electronic warfare methods are needed to achieve surprise. Furthermore, formerly surprise was just a temporary factor in the campaign inasmuch as the weapons had only limited capabilities for inflicting casualties on the enemy during a short period of time. Today, however, the surprise element is highly effective; the damage inflicted on the enemy within a short period of time by long range weapons may produce decisive results for the campaign. Soviet navy commander-in-chief V. Cheravin said: "The element of surprise has increased markedly with the rapid development of modern weapons. The side that achieves surprise may be able to win extremely great superiority during the early period of a campaign or even throughout the campaign." (V. Cheravin, "Various Categories of Naval Science Under Modern Conditions"). Therefore, the Soviet navy's present emphasis on the "surprise" principle holds profound significance.

Comparison of the naval mobile warfare theory of the United States with the Soviet Union's principle of surprise reveals the following:

**First, Study of the Main Themes of American and Soviet Navy Operations Theory Shows Differences in Approach but Equally Satisfactory Results.**

The American navy's mobile warfare theory grew out of the inadequacy of the former war of attrition theory. The emphasis in war of attrition theory was on "war surplus rates," and "matched exchange rates." However, the United States is no longer prepared to fight another World War I or World War II, or a war of attrition requiring overwhelming material superiority such as the Korean War or the Vietnam War. Therefore, the United States Navy believes that "a theory built around war of attrition theory is no longer a practical theory." The guiding thought in campaigns has to be changed from "winning victory through quantity" to "winning victory through quality," preparations being made to fight a naval war in which "inferior strength can triumph over superior strength" as was done [against Japan] during the first half of 1942."

The Soviet navy's prominent emphasis on the principle of surprise grew out of a concentration of the quintessence of various principles following dissatisfaction with old principles. For example, (Starbo) maintained that the principle of "concentrated use of troops" could be used most effectively when the destructive force of one's weapons was not great, and the hit rate was not high at usually no more than several percent. Today, however, the advent of guided weapons of great power and accuracy has decreased the need to employ concentrated troops. The point has not been reached where the concentrated use of troops is essential in battles and campaigns. The accuracy of modern weapons is high, and their destructive power great. By using surprise, a single aircraft, a single vessel, or a single strike group can directly achieve campaign objectives (meaning the annihilation of operational targets). Therefore, it is not the number of troops but the quality of troops that counts in modern naval warfare; the use of surprise to achieve victory from a first strike is realistic, and it is easier to achieve the requirements of principles such as "seizing and controlling the initiative," and "a high degree of combat initiative and determination."

We can see from the above that despite different intentions and different focuses, the final results from the changed direction of American and Soviet naval operations theories are extremely similar. American navy commander Robert D. (Kars) said, "Causing confusion, creating chaos, use of trickery, and maneuvering are all for the purpose of creating surprise and catching the enemy unawares." Clearly, mobile warfare theory and the principle of surprise are extremely similar in their goals. The two are also very similar in their methods. In the course of maneuvering by the naval forces of both sides in modern naval operations, external contact in the form of observation, communications, command, and control cannot be made without electronics equipment. Obviously all actions that are taken to puzzle or deceive must rely on electronics warfare methods in combination with movement in order to be successful. This is likewise a basic technique for achieving surprise. V. Cheravin said: "Formerly the main method for achieving surprise was to make campaign (or battle)

preparations ahead of the enemy, carefully camouflaging, and concealing campaign intentions so as to mislead the enemy about the time, the scale, the location, and the main direction of the campaign. Under modern conditions, new advances have been made in the methods used to attain surprise. In order to achieve surprise, the side that is taking the offensive makes wide use of all sorts of electronic warfare gear for the concentrated and complete destruction of the enemy's observation, reconnaissance, command, and weapons control systems, while simultaneously improving the camouflaging of his own targets in order to befuddle the enemy temporarily." (V. Cheravin, "Various Categories of Naval Science Under Modern Conditions.") Therefore, in terms of similarities in goals and methods, we would say that the American navy's mobile warfare theory and the Soviet navy's emphasis on the surprise principle differ in approach but aim at the same results.

**Second, The Main Theme in the Study of American and Soviet Navy Operations Theory Gives Prominence to the Role of Electronic Warfare in Future Naval Operations Which Portrays a Backdrop of High Technology Warfare.**

Mobile Warfare Theory and emphasis on the principle of surprise are both stratagems, but these stratagems are not stratagems in the general sense of the term, but rather are stratagems under modern conditions that are filled with artistry. We know that when electronic warfare is used properly, it can block enemy communications, prevent the enemy from seeing, and make it impossible for the enemy to fight, placing him in an extremely passive predicament. The weapons that the United States used in the surprise attack against Libya had formerly shown up in the Vietnam War, and there was nothing startling about them. Success in this surprise attack on Libya lay in the ingenious maneuvering and the good organization of electronic warfare. The United States regards electronic warfare as a military action and not as a support action, which makes a lot of sense. In tactical terms, the enemy's naval vessels and naval groups are fortified points. They are self-contained observation and attack systems having fairly stable internal communications, and a fairly short combat reaction cycle. Electronic warfare is more effective than firepower support against them. It was also for this reason that Commander (Kars) maintained that "naval mobile warfare" theory is not applicable in a tactical sense. It applies only at the campaign level. Therefore, electronic warfare actually plays the role of cutting off and surrounding the enemy. In this sense, electronic warfare is no longer a support action; it is an all out attack in the first wave of a campaign, and it is an attack that is all pervasive. The succeeding second wave is an attack in the form of "pressure applied to critical points." Possibly mastery of the sea through mastery of electromagnetism may play a future role; it is also a piece of artistry in stratagems used under today's conditions. One might say that the situation in naval operations under future conditions of high technology warfare will be largely like this.



**Third, The Main Theme in the Study of American and Soviet Naval Operations Theories Reflects a Substantial Closeness in the Linking of Theory and Reality.**

The starting point for Soviet naval operations theory is guided weapons, but the starting point for American naval operations theory is aircraft carriers and their aircraft. Unless the Soviet navy prepares to control the air, it will be very difficult for it to contend with the American navy; therefore, the Soviet navy's campaign response can only be a surprise attack, primarily using surprise to gain early dominance in military operations and to seize the initiative. The American navy's aircraft carrier combat groups are extraordinarily limited in number, and should they simultaneously face a threat from all sorts of guided missile launch platform combat groups, their operational response can only be to make greatest use of their own technical superiority to seize and maintain the initiative to attack and destroy the enemy one by one.

To summarize the foregoing, the main themes of American and Soviet naval operations theory reflects the basic trends in future naval operations. Inasmuch as surprise and counter surprise methods are in process of development, competition between the operational theories will increasingly develop in the direction of a combination of high technology and artistry. Modern naval operations are tending less and less toward "imposing arrays of military strength" and more and more toward surprise attacks. The element of mystery and wonder is more pronounced in stratagems.

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**Evolving Nature of Soviet Operational Offensive**  
40050264 Beijing GUOFANG DAXUE XUEBAO  
[NATIONAL DEFENSE UNIVERSITY JOURNAL] in  
Chinese No 12 1 Dec 87 pp 75-77, 69

[Article by Army Commander Chen Xitao [7115 1585 3325]: "Main Features of Soviet Army's Modern Operational Offensives"]

[Text] Accompanying advances in the new technological revolution since the 1970's has been a readjustment of military strategy and a change in combat thinking. "Great-depth operations" theory has been used as the foundation from which new changes have been made in the Soviet army's offensive operations theory. From some theoretical articles that the Soviet army has published, three basic concepts are evident as follows: First is the integrated ground and air strike (including sea strikes in coastal area combat zones). Second is the great-depth strike. Third is the simultaneous strike. These fundamental concepts show the Soviet army's basic thinking about modern offensive operations theory to be as follows: concentrated use of air and land (or sea) strike groups to launch simultaneous in-depth strikes

within the entire space (land, air, and sea) against the enemy's operational deployments, i.e., "simultaneous great-depth ground and air strikes."

**1. Three Dimensional Nature of Offensive, Emphasizing Combined Ground and Air Strikes, from Slogging Ground Advances Changing Gradually to All-Out Great-depth Ground and Air Strikes.**

During World War II, despite the increase in the degree of mechanization of military forces, the marked increase in artillery ranges, the considerable development of air forces, and the brand new role of airborne troops, which greatly increased the speed with which offensive operations advanced, and brought about three dimensional warfare, hard slogging on the ground still remained a form of combat. With the swift development of science and technology after the war came an unprecedented development of troop mobility, and particularly a great increase in mobility in the air, in the great power, accuracy and long range of firepower, and in the coordinated combat capabilities of all services and branches of service. Military forces possessed the capability to carry out quick strikes against the most important targets in the rearmost areas of a defending enemy. As a result, the Soviet army believes that the main method for conducting modern offensive operations is not gradual "gnawing" away at defensive positions where the most up-to-date types of tank weapons and armored weapons are arrayed, nor is it to beat back attacks from rapidly moving reserves, but rather it is to coordinate the large-scale use of ground and air troops, employing firepower and fast military groups against the most important and the most easily destroyed targets deep in the rear of the enemy's operations deployments, while carrying out powerful attacks simultaneously so as to achieve the goals of the offensive in the shortest possible time. Clearly, in any future offensive combat, the Soviet army will not keep "gnawing" away at the opponent's defenses, but rather will employ ground and air strike groups for attacks against great-depth enemy defenses while simultaneously advancing.

Great depth strikes do not mean just knocking out great-depth firepower, but rather is the carrying out of in-depth attacks against troops after having knocked out great-depth enemy firepower. It is a "combined advance" in depth carried out by combined ground and air forces. The Soviet army has the world's most powerful airborne forces. Local, front, and group armies all have airborne divisions, or airborne attack brigades (or battalions), and the trend is toward expansion of their numbers. This is the main force for air attacks. In addition, the Soviet armed forces are currently in the process of expanding their army air forces, are researching and developing all kinds of technical devices for air movements, and are hurrying to completion a "tri-level broad jump" that makes the army more like a cavalry, more mechanized, and more like an air force, endowing ground forces with amphibious ground and air attack capabilities.

This complete in-depth offensive method used by the Soviet armed forces is very possibly a combat process that goes from "point to line to front." By point is meant that simultaneous with the launching of an attack along many routes across a broad front, air (or mechanized infantry) drops are made at many points deep behind the opponent's defenses to capture the opponent's in-depth command centers, communications hubs, defensive strong points and other important targets. By "line" is meant that after making breakthroughs at many locations, attack groups such as mobile operations groups and advance contingents are used to drive a wedge at high speed deep into the enemy's rear in many directions and via many routes, using the method of "threading a needle" to rendezvous quickly with airborne (or mechanized infantry) troops, forming an intersected breakthrough network and cutting up the opponent's defense system. By "front" is meant making use of this "spider web-like" breakthrough for continued development of victory, expanding front and rear, to the left and to the right, pulverizing the opponent's defense system, and wiping out defending groups.

**2. In-depth Nature of Combat Targets—Stress on a Combination of Frontal and In-depth Strikes, Emphasis Being Placed on Frontal Attack, First To Wipe Out Massive Numbers of the Opponent's Forces, Gradually Changing to and Emphasis on In-depth Strikes for the Purpose of Paralyzing the Opponent's Defense System First.**

Formerly, the focus of combat was frequently located near the line where the two sides were in contact; therefore, the targets of operational combat could only be the large numbers of troops in the enemy's frontlines. In modern offensive operations, in which military forces possess the ability to make great-depth attacks, the main targets of operational combat have also changed to those deep behind the enemy lines. The Soviet army maintains that the traditional "main targets of an offensive are military units, and army groups deployed on the battlefield," but "under modern conditions, circumstances have changed fundamentally; the main targets of an offensive will be targets located behind the front lines inside the enemy's country." "In 'Military Strategy' by Sokolov, theater strategic operations is a term used mostly to mean major strategic and operations objectives such as the adversary's political, economic, and military centers, and strategic nuclear launch sites. The terms front army and group army operations are used mostly to mean important operations targets such as the adversary's behind-the-lines command posts, reserve (second echelon) deployment areas, long-range weapons, communications hubs, main transportation arteries, and resupply pipelines.

It is generally realized that modern operations have become larger and larger in scale, and the larger the scale, the more encompassing they have become. The more encompassing they have become, the higher the demands posed for command, control, coordination,

communications, and resupply. If just a single link is missing, the entire system may go out of control and become unbalanced. The Soviet armed forces emphasis on in-depth strikes is simply for the purpose of slitting open the opponent's soft underbelly to destroy the enemy army's operational dispositions and to paralyze the opponent's entire defense system from within. The main techniques used to do this are as follows: (1) Use of operations and tactical rockets, air units, combat helicopters and artillery to "knock out great-depth firepower." (2) Organization of rapid maneuver groups, advance detachments, and special combat forces to carry out "great-depth long-range raids." (3) Use of differently organized airborne formations, units, and airborne assault brigades (or battalions), and all sorts of motorized infantry transported by air to carry out "great-depth aerial encirclements." These three kinds of "great-depth" operations will permit the following in an offensive operations: (1) Leapfrogging. A large number of formations and units will be able to "leap over" the adversary's frontline fortifications area and directly penetrate the adversary's far rear areas to wage war. (2) Intersecting. The focus of combat will no longer be limited to breaking through the frontline. When breakthroughs in the front and battles in the rear occur at the same time, the boundary between the front and the rear will become muddled, and offense, defense, and chance encounters may all occur at the same time in the adversary's rear, the center of combat shifting to the rear. Sometimes, the "confrontation of the two armies may become a secondary matter" (3) Strangulation. Offensive combat will focus more on how to seize (or wipe out) important targets in the adversary's rear area such as command posts, and communications and transportation hubs, to undermine and weaken the adversary's will and capacity to resist, and to paralyze the adversary's entire defense system, strangling the adversary's defense from within in close coordination with a frontal attack for rapid attainment of the goals of the operations.

**3. Speed of Combat Tempo—Emphasis on a Combination of Continuing and Simultaneous Attacks, Gradually Transforming a Series of Continuing Strikes into the Carrying Out of a Single Powerful Strike of Short Duration**

Accompanying the high speed development of technical weapons has been a marked increase in military forces' firepower, mobility, and striking power. A future Soviet offensive operations may have the following characteristics: (1) Large Scale. The Soviet armed forces maintain that future offensive combat movements will take place at a higher level and on a larger scale; operations and strategy will be more closely dovetailed, and the basic style of the operations will be that of a "combat theatre strategic operations." (2) High Technology. The Soviet armed forces predict that a future war will be a new-type conventional war that differs vastly from past wars. The power of various destructive weapons will become greater and greater, their range will become ever greater, and their accuracy will become higher and higher, and

these weapons are now being systematized and made smart. (3) High Speed. The Soviet army believes that modern operations are more mobile, and faster. The time factor has become the most precious factor in warfare to the point where victory or defeat in a operations may be decided in the twinkling of an eye. Thus, the intensity of operations will inevitably become greater and greater, and time will become shorter. Where formerly a series of medium and small scale operational attacks were necessary to complete a combat mission, today only several or a single large operational attack will do the job.

In the Soviet armed forces, such single powerful strikes may hold two implications as follows: First is an expansion of the first strike. The Soviet armed forces maintain that operational warfare's "substance, form, and duration are not necessarily the same in separate battles; nevertheless, they do share a common pattern, namely that as weapons develop, the role of the first strike continues to become greater." (from "The Dialectical Method and Modern Military Affairs" by the Soviet (Geluduoning)) Such a powerful first strike frequently brings together most military forces in the theater and in the operations, or even all services and service arms and their various weapons. "An enemy battlefield that is able to sustain scores of small attacks will be unable to sustain a single large attack." (from "Soviet Style Combat Methods" by the American (Neisen)) Another aspect is that the sustained, slogging nature of operational engagements and battles of the past has been transformed into the simultaneous execution of a single more powerful operation in which the tempo is faster and the time between attacks in the operation is shorter, thereby expanding the area over which the operation is fought while shortening its duration.

Such a single powerful and brief strike will truly make future operations lightning-like. It took the Soviet army only 6 hours to invade Czechoslovakia, and only 3 hours to invade Afghanistan, occupy their capital cities, and get control of the situation in these two countries. Even a fascist German aggressor who considered himself a "Blitzkrieg hero" might pale at this.

#### **4. Totality of Strike Tactics. Attention to a Combination of Firepower and Total Strikes, Changing Gradually from Reliance on Firepower to the Use of Multiple Methods in Combination for a Total Knockout.**

The Soviet army believes that in modern warfare firepower is the mainstay of operations. In order to deliver "simultaneous great-depth attacks from the ground and air," the following will characterize the Soviet army's use of firepower to effect a knockout: (1) Greater ability to wage war in distant places. The Soviet army believes that it is "now able to carry out missions entirely by using firepower deep inside the enemy's territory to achieve a knockout. This is because it both possesses the material basis for greatly expanding firepower strikes deep within

the enemy's territory, and because the enemy has concentrated large numbers of nuclear attack weapons, reconnaissance-strike systems, combat helicopters, and tactical air troops at places near combat contact lines and behind their deployments, and has also set up important command posts, communications hubs, and logistics facilities there. Therefore, objectively speaking, it is necessary not only to wipe out targets that the enemy has concentrated near the combat contact lines, but also to wipe out targets that the enemy has concentrated in depth behind deployments." ((Voluobiev), Soviet, "New Weapons and New Techniques"). (2) Integration. By this is meant the use of various kinds of precision-guided weapons, operational and tactical rockets, airplanes, helicopters, tanks, and infantry weapons from different altitudes, different distances, and different directions, simultaneously bringing to bear all available firepower for a great in-depth attack against the enemy's defenses to effect a total knockout. (3) High Efficiency. The Soviet army believes there is a trend toward increasing the depth to which firepower can be used in a knockout, missions being completed within a short period of time and optimum results being obtained. The fire support formerly given at the time of advance when troops inched along, the fire preparation in advance of an assault, the fire support rendered at the time of attack, and the fire protection supplied for deep thrusts did not seem completely coordinated because simultaneous advances were carried out deep into the enemy's rear. Very possibly, all that could be depended on was a suppression of the enemy's entire defensive rear, and uninterrupted firepower assistance for the attacking forces. The duration of fire strikes is much shorter and the procedures much simpler, yet destruction is greater.

In addition, looked at from the angle of development, the Soviet army's use of various strike tactics in combination in offensive operations to effect a knockout is becoming increasingly noticeable. Even though the scale of the Soviet army's modern offensive operations is so vast, the duration so short, and requirements so high, and though fire strike capabilities have developed by leaps and bounds, nevertheless, complete reliance on firepower is neither easy nor achievable. A look at external factors in an operation show two trends that need close attention. One is the effect of strategy. The large size of modern Soviet army operations, particularly of war theater strategic operations, has linked strategy and operations more closely, and an ever increasing number of forms of combat are used in operations to attain strategic objectives. Thus, the area that can be covered by firepower will be greatly exceeded. In view of the pattern of development of weaponry from cold weapons to hot weapons, to high energy weapons, the Soviet army is currently conducting research on laser weapons, particle beam weapons, directed energy weapons, and subsonic weapons. Some of these new weapons have been used in real warfare, and some may be used before long. This trend of development cannot but have an effect on the Soviet army's offensive operations. A



look at inherent factors in operations shows two problems that also cannot be ignored. One is the larger size of operational targets. The Soviet army emphasizes in-depth strikes, and in-depth targets means mostly command centers, communications hubs, transportation hubs, industrial bases, and densely populated residential areas. Firepower cannot destroy or cannot be used against some of these targets. An example is C<sup>3</sup>I systems which are highly protected and mobile. Destroying (or suppressing) such targets requires not only firepower but, more importantly, electronic warfare. The Soviet army has stated explicitly that the most effective way to carry out such a mission is to destroy entirely these important targets, or to use electronic counterweapons to suppress them. Second is the steadily increasing area covered by operations. Firepower cannot cover such large areas; thus firepower must be used in conjunction with other methods. Therefore, one can deduce that in its future offensive operations, the Soviet army will organically combine the use of firepower warfare with electronic warfare, biochemical warfare, high energy weapons warfare, and political and psychological warfare, using visible and invisible attacks, and lethal and non-lethal attacks in conjunction to inflict a multiplicity of casualties.

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#### **Deng's Continuation of Mao Zedong Military Thought**

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[Article by Zhao Shufeng [6392 2885 1496] of the Dalian Army College: "On Comrade Deng Xiaoping's Continuation and Development of Mao Zedong's Thought on War and Peace"]

[Text] Comrade Deng Xiaoping is an outstanding Marxist. In the era of the revolutionary war, with abundant practice in struggle and profound theoretical reflections, he made important contributions to the formation, development and improvement of Mao Zedong's military thought. In the new historical period, in upholding and developing Mao Zedong's military thought, through incisive analysis of the enormous changes in post-World War II international relations, Comrade Deng Xiaoping reached some new theses with regard to issues of war and peace which concern the fate of mankind and social development, and provided scientific theoretical basis for strategic changes in the guiding thinking of military construction.

1. He reached the important thesis that the cause of current world intranquility is the rivalry of hegemonism and he continued and developed Mao Zedong thought on the origins of war.

What is the origin of war? Mao Zedong loyally continued the fundamental viewpoint of Marxism-Leninism on this issue. He said: Private ownership and imperialism are the criminal causes of war, the imperialist system brews war, "and only when imperialism has been abolished will there be peace." (COLLECTED WORKS OF MAO ZEDONG, Vol 5 p 291) After World War II, although the rivalry between the imperialist countries for cheap raw materials and the struggle for markets still continued violently and the unavoidability of struggle between them still existed, major changes took place in the situation so that using the theses of Marxist-Leninist sages could no longer completely explain the fact that wars have occurred in the past 40 years. To wit, not one of the over 180 local wars and armed conflicts that have occurred since the war was directly between the major capitalist countries; on the contrary, war repeatedly broke out between countries of the third world and even socialist countries. Mao Zedong had carried out conscientious explorations of this strange phenomenon in the history of mankind's wars during his lifetime. He once said: "The U.S. has interests in the world it wants to safeguard, the USSR wants to expand, and there is no way this will change, so in an era when classes exist, war is a phenomenon between two peaces." (RENMIN RIBAO, 23 August 1977) This thesis exposed to a certain degree the fact that the struggle between the U.S. and the USSR is a major danger of the development and outbreak of war. However, because we were still bound by traditional ideas, he viewed the promotion of hegemonism by socialist countries as "a phenomenon of the era when classes exist" and referred to it as "socialist imperialism", thus the features of the causes of war at the time were still not really revealed to form a clearer and more specific theory of the root causes of war.

After the Third Plenary Session of the 11th Party Central Committee once again established seeking truth from facts as the ideological line, through a thorough analysis of the post-war international situation, Comrade Deng Xiaoping reached an addition scientific thesis on the issue of the causes of war in the current era. He pointed out sharply: "The source of intranquility in the world today is the rivalry of hegemonism." (RENMIN RIBAO, 18 May 1984) "War is linked with hegemonism." (LIAOWANG, No 5, 1985 p 9) This is an apt thesis concerning the turbulent international situation since the war. The facts are these. Although a new world war did not break out after World War II, the superpowers utilized regional conflicts and the various economic difficulties and problems of the developing countries and either used various means to carry out infiltration and expansion, provoked wars among agent countries, carried out behind the scenes control, or directly dispatched troops for invasion so that local wars have never stopped. These historical facts prove conclusively that Comrade Deng Xiaoping's thesis on the causes of war are correct.

On the basis of in-depth analysis of the world situation and the pattern of war, Comrade Deng Xiaoping pointed out very clearly that the primary danger of war is the

rivalry of the two hegemonists, the U.S. and the USSR. He said: "Only the U.S. and the USSR now have the ability to start a world war." (RENMIN RIBAO, 10 April 1986) This is another scientific thesis that completely conforms with reality. Because they have pursued a hegemonistic war policies, since the war, the U.S. and the USSR have actively exploited military strategy and their military forces have far exceeded the needs of legitimate defense. If this trend is not contained, at some point it is bound to cause a tipping of the scales of the arms race and thus increase the danger of war.

Comrade Deng Xiaoping's thesis on the cause of war is an outstanding development of Mao Zedong's theory of the causes of war. His outstanding contributions are: first, he explained that at different historical periods of human society the primary manifestations of the causes of war are different. According to the Marxist viewpoint, the basic cause of war is the contradiction between productive forces and the forms of association. This basic theory of the cause of war provided a general theoretical basis for explaining the origins of war under different economic formations. Lenin's conclusion that "Imperialism is war" comes from the time of World War I, a period when capitalism was in the ascendant, imperialist powers were taking shape, and their struggle to carve up the world's colonies was unceasing. This thesis was borne out by the history of World War II. Yet, after World War II, the socialist countries grew rapidly, some old-line capitalist countries gradually declined, and national independence movements ran unprecedently high. This not only brought about an enormous change in world structure, but also led to the rivalry of various new forms of political, military and economic interests. This rivalry primarily appeared as hegemonism of external aggression, expansion and the attempt to control others and this brought along world turbulence. Therefore, the "Doctrine of hegemonism causes war" which was raised from the reality of this historical stage of social development was a development of the "Doctrine of imperialism causes war" and the two are specific applications of the basic Marxist theory of the cause of war. Second, he revealed that if a socialist country engages in hegemonism this too can become a cause of war. We know that actual socialism is a stage in the process of the development of social formation and is still a long way from perfect theoretical socialism. In this stage, due to the inherited nature of the history of the ideology, errors in theory, and the predatory nature of social and economic development engendered by this, some socialist countries attempt to control other countries politically, economically, and militarily and must also become causes of war. Third, he pointed out the most dangerous elements in the causes of war. In the present world hegemonism has made everyone intranquil but hegemonism is divided into world and regional, big hegemonies and small hegemonies. Only the world hegemonism pursued by the superpowers is the most important and most dangerous element in world war.

2. He brought to light the profound philosophy that if work is done properly, world war can be delayed and avoided, and he continued and developed Mao Zedong's thought on forecasting war.

Responding to the development trends of war and peace, especially determining the development and outbreak of war and the degree of danger to peace is an important part of Mao Zedong thought on war and peace. Using the methods of dialectical materialism and historical materialism, Mao Zedong investigated war, continued and developed the traditional viewpoint of Marxism-Leninism which holds that war is a phenomenon between two peoples and only with the existence of private property and classes is war unavoidable and formed a war predicting thought guided by this. On the basis of the historical facts of World War I and the first stage imperialist rivalry of World War II, he clearly pointed out: "In the imperialist period, the development of capitalism was extremely unbalanced, thus war between the imperialist countries was unavoidable." (COLLECTED MILITARY WRITINGS OF MAO ZEDONG, internal edition, p 210) He believed that only if a world communist party could unify all possible peaceful democratic forces and bring about greater growth could a new world war be stopped. At the time, these theses played an appropriate guiding role in encouraging the people to carry on a struggle with the menace and blackmail of imperialist and reactionary war. Historical facts have proven that this is a correct viewpoint. However, at the time the possibility of avoiding the reality of a new outbreak of war was not very outstanding, especially under circumstances of the U.S. launching a war to invade Vietnam and the constant escalation of the USSR's anti-Chinese [activities] and he again believed that war was coming ever closer and was even imminent. In a later talk, Mao Zedong said: "It is not that you want to fight a world war or we want to or the third world wants to fight a world war, nor is it the people of these rich countries who want to fight a world war, this is something which is not brought about by the will of people." (EXTRACTS FROM MAO ZEDONG'S THEORIES OF PEOPLE'S ARMY, PEOPLE'S WAR, AND THEIR STRATEGY AND TACTICS, p 128) Here he both consciously and unconsciously abandoned the correct exploration of predicting war which had already begun and returned to the track of "war is unavoidable" which continued to serve as the guiding thinking in national defense strategy for a very long time.

Through scientific analysis and long term investigation of the profound changes in post-war international relations, Comrade Deng Xiaoping made some breakthrough determinations and conclusions concerning the development trends of war and peace. In recent years, focusing on the issue of predicting war, he both revealed that the social phenomenon of war is generally speaking unavoidable and that the threat of a new world war has not yet been eliminated, and analyzed the realistic possibility which exist for avoiding a new world war. In 1984 Comrade Deng Xiaoping said: "The danger of war

always exists, but peace is hoped for." (RENMIN RIBAO, 8 November 1984) In 1985 he further pointed out: "Although the danger of war still exists, if we do it right, war is avoidable." (RENMIN RIBAO, 15 September 1985) By 1986, Comrade Deng Xiaoping pointed out even more clearly: "In the past we said that world war was unavoidable, and now we have changed this viewpoint and based on the development trends in the international situation, peace can be won, though to win peace a series of tasks must be done." (RENMIN RIBAO, 24 April 1986) These famous theses of Comrade Deng Xiaoping with regard to predicting war conform completely with the objective reality of today's world. This is because the increase in world peace forces is overtaking the increase in war forces and an enormous assault force and restraining force has formed directly vis-a-vis war forces. Facts also show us that since the European countries are unwilling to be restrained by the superpowers the collective consciousness is inattentive, the extensive interpenetration of economic interests among the countries also has given rise to self-restraint and weakening of war forces and at the same time, the nuclear parity of the U.S. and the USSR superpowers and the mutual threat created by second-strike capability keeps the war maniacs from daring to rashly start a large-scale war. The formation and further development of these conditions can cause world peace to continue forward in a special environment.

On the issue of what methods to adopt to be able to win the peace, Comrade Deng Xiaoping points out: "There are many conflicts in the world and ways should always be found to resolve problems. For many years I have been of the opinion that whatever method is used to resolve this problem, it should not be a war method, but should be a peaceful means." "I also imagine that some international territorial disputes may not start by discussing the issue of sovereignty, but should begin by carrying out joint development." (BUILDING SOCIALISM WITH CHINESE CHARACTERISTICS, Rev. ed. pp 38, 39) Later he also pointed out: "If resolved poorly, many international disputes may turn into explosive points. I wonder if it is that some places can adopt the method of 'one country and two systems' and some places can also employ the method of 'joint development.'" (Ibid., p 72) Under the present circumstances in which peaceful forces outweigh the war forces, Comrade Deng Xiaoping's idea of resolving international disputes by peaceful means conforms to the interests of the countries of the world. This is because weak and small countries, even including some of the countries of the second world, want to build, want to develop and do not want war; the expansive and predatory methods of the superpowers also have changed and may not necessarily resort to force. This gives a definite social foundation to the realization of this idea. After China used this peaceful method to successfully resolve the issue of Hong Kong and Macao, Comrade Deng Xiaoping gave his complete approval and said: The "one country and two systems" idea which we proposed seems to be successful. Using this method to resolve the issue of Macao can be

said to have provided a test case for resolving international disputes and eliminating international hot spots.

In summary, Comrade Deng Xiaoping advanced Mao Zedong's thought on predicting war to a higher level, both inheriting the essence of Mao Zedong's thought on predicting war as well as not just copying some viewpoints, but carrying out developmental explorations and demonstrations. To sum up, it includes the following points: 1. He revealed the reality that world war is avoidable in the general situation in which war is unavoidable. Not to accept as a whole the social phenomenon that in a class society war is unavoidable is clearly an error. However, the social phenomenon of war has many and varied forms of expression. That limited war and regional conflicts are unavoidable is not equivalent to world war being unavoidable. Comrade Deng Xiaoping smashed this determination as a simple equation and carried out a comprehensive analysis of the development trends of various forms of war and by seeking truth from facts arrived at the correct conclusion that major war could be postponed and avoided. 2. He explained that man has a powerfully active role in stopping war and winning peace. A war which can be started with an enemy must be prepared for and dealt with conscientiously. There is no doubt of this. And it is on this foundation that Comrade Deng Xiaoping viewed man not as powerless and inertial with regard to war but as having an enormous active role. As long as man's subjective activity is fully exploited, the mechanism for stopping war is aroused and peaceful elements increased, then the forces of war can be restrained and the goal of postponing and avoiding war be achieved. This actively broadened our outlook on predicting and controlling war and increased our awareness of taking preventive measures. 3. He creatively proposed and put into practice a new path for resolving disputes by peaceful methods. There is a very big relationship between determining the shift of war and peace and the methods used to resolve disputes. Comrade Deng Xiaoping has made the methods of resolving disputes an important issue in maintaining peace and has repeatedly emphasized that founded on the five principles of peaceful coexistence, active peaceful methods should be adopted as much as possible to resolve disputes so that the international situation will develop in a direction which favors stopping the outbreak of a new world war.

3. He made the use of a peaceful environment the correct policy for fundamentally strengthening national defense modernization and carried on and developed Mao Zedong thought concerning war preparations.

Establishing a policy of war preparations in peacetime was also an important part of Mao Zedong's thinking on war and peace. "Proceeding from the worst-case scenario" is a consistent idea of Mao Zedong's in making preparations for a war of aggression. Under the guidance of this thinking, our war preparations are fundamentally based on how to carry out all-out war with primary combat object. Thus, ideologically, this means living



days of relative peace in tension, always in a state of readiness on the verge of war; in terms of combat forces, continuing to strive for superiority of numbers while simultaneously maintaining strong conventional forces and organizing contingents of the people's militia in a big way; in terms of national defense, not stinting on manpower, materiel or finances to construct battlefields and national defense facilities on a large scale; in terms of combat materiel, carrying out production and stockpiling primarily in terms of existing weapons and equipment; in terms of education and training, stressing summarizing possible combat missions and giving secondary importance to carrying out combat advance drills. These war preparations under the present circumstances have played a definite positive role in withstanding the pressure of hegemonism and maintaining national security. However, without considering the possible greater or lesser urgency of potential wars or the nearness of the enemy's threat makes this guiding ideology continue for a long time and if we "prepare for war, prepare for war, prepare but don't fight" for a dozen years, undoubtedly it will have an unfavorable influence on the development of the national economy and modernization of national defense.

In this process, Mao Zedong soberly realized this problem and had expounded on it throughout. In "On The Ten Great Relationships" he thoroughly expounded on the relationship between economic construction and national defense construction and pointed out that to strengthen national defense forces and do a good job of war preparations, "a reliable method is to lower army and government expenses to an appropriate ratio and increase economic construction expenses. Only if economic construction grows faster, can national defense construction move at a greater pace." (COLLECTED WORKS OF MAO ZEDONG, Vol 5 p 271) However, the regrettable thing is that with the rise of the "Great Cultural Revolution" and the overly severe estimates of the international situation, this correct stand of his could not be maintained well and thoroughly carried out, directly obstructing the improvement of the entire country's overall war capacity.

Based on the profound observations and correct determination of the international war and peace situation and while making the party's ideological line and government line shift to the correct track of Marxism-Leninism, Comrade Deng Xiaoping also caused the thinking of Mao Zedong on the correct handling of the relationship of economic construction and national defense construction to be implemented and promptly made the major policy decision of shifting national defense modernization to peacetime construction and fundamentally strengthened war preparations. At the Military Commission forum which he convened in November 1984, he pointed out emphatically: Our armed forces have their own responsibility in subordinating themselves to the situation of national construction. The armed forces should take this general situation as a whole into consideration. They should act in this

general situation. All aspects of the armed forces should have a relationship with national construction and should consider how to support and actively participate in national construction. He also pointed out: The armed forces should vigorously support national construction and strive to achieve the great goal of realizing a quadrupling of the entire nation at an early date so that the national economy begins to fully develop. If national strength is greatly increased, then national construction will be easy. At the expanded meeting of the Military Commission in 1985, after making a succinct discussion of the international strategic setup and war situation, he further emphasized: China should concentrate its forces to engage in economic construction and build China into a powerful, socialist modernized country. We need a peaceful international environment and we are striving to create and maintain this peaceful environment. Economic construction is our general situation and everything should serve this general situation. Later he also pointed out that China is a force for maintaining world peace and China's development means a strengthening of the forces for maintaining peace and restricting war. From the theses mentioned above, we can understand that the war preparation thinking emphasized by Comrade Deng Xiaoping, is to fully utilize the relatively peaceful environment before the beginning of a major long-term war and while subordinated to national economic construction, through the growth of economic construction, it has promoted the pace of national defense construction implying that war preparations lie in improvement of overall national defense capacity. This thinking tells us that on the one hand, we cannot act with undue haste with regard to the issue of developing national defense forces and war preparations, but on the other hand we also definitely cannot relax our notion of national defense. Facts prove that Comrade Deng Xiaoping's proposal of this type of war preparations thinking has introduced an exuberant vitality into our military construction. The one million man reduction in force was completed smoothly, our army's authorized strength system is more sensible, our weapons and equipment have been improved, our system of regulations is gradually being improved and the administration of our armed forces is steadily improving. All of this is sufficient to establish that a rich country and powerful army advancing in step is the correct road of development which has powerful vitality.

Comrade Deng Xiaoping's improvement of national defense construction thinking from the very bottom has enriched and developed Mao Zedong's theories on war preparation thinking. The specific manifestations are: 1. In terms of the idea of war preparations, he emphasized the organic coordination of the ideas that if there is a war we must be prepared and if there are preparations there must be a system. We should clarify the background of war preparations in a seeking truth from facts manner, get an accurate idea of the objective preconditions of implementing appropriate preparations, make the reality of the threat of war a "regulator" of war preparations and both be constantly on the alert for the threat of war,

not relax necessary preparations and always make war preparations balanced. 2. In terms of war preparations, he emphasized unified planning for economic development and national defense construction. Fundamentally improve war preparations by utilizing a relatively peaceful environment, upholding the integration of war and peace, the compatibility of military and civilian, through the basic path of high benefits of economic construction and the long term growth of national defense forces. 3. In terms of the goal of war preparations, he stressed simultaneous undertaking victory in war and curbing war and winning peace so that the goal of war preparations is even more complete. In summary, war preparations in peacetime are not only to win victory in a future war, but are also to delay and avoid the outbreak of war and make the appropriate contribution to winning peace.

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#### **Need for Operations Theory Research**

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[Article by Zhang Lin [1728 7207], with Zang Shiming [5258 1102 2494] as responsible editor: "Let Us Pursue the Study of Operations Theory in Greater Depth"]

[Text] At present, the forces of peace are continuously gaining in strength, which makes it impossible for the time being to start a world war, so that study of military theories has become a "soft warfare" without the smoke of gunpowder. Following the rapid development of science and technology as well as of weapons and equipment of war, foreign armies vie with each other in devising their particular strategy and operations theories; they are the "outpost skirmishes" of the future war. To be prepared in case need arises to repel a future war of aggression, we must meet the challenge of military theories of the various foreign countries and devote energy and time a study in greater depth of our own operations theory, in order to develop, in a comprehensive and systematic manner, a modern operations theory of unique Chinese military character.

#### **1. On the Foundation Bequeathed to Us, Let Us Develop a Modern Operations Theory of Unique Chinese Military Character**

Our army is a people's army with a history of 60 years of armed struggle and peacetime development. In the practical experiences of fighting under conditions of extreme hardship and difficulties, a modern military theory has taken shape: the military thought of Mao Zedong. At the same time, a special method and theory of operations with unique characteristics of its own was creatively developed. Through the practical experiences of war, these theories have taken deep roots in China's soil. In a study and exploration of China's modern operations theory, especially in a discussion of fundamental Chinese thinking on military operations, we must acquaint

ourselves fully with China's traditional methods of warfare, and combine this basic factor with the developmental changes that have evolved under modern conditions. We must be in control of developmental trends that will govern conditions on future battlefields, we must put forward basic ideas on military operations that suit the realities of China's armed forces, and we must establish a modern system of Chinese military operations theory.

Principles of military action by any military force, including their operations theories, are influenced and conditioned by the special conditions of the particular country concerned. A theory that is divorced from the realities of the country in question will certainly lack all vitality. For instance, the "great-depth operations" and "Air-Land Integrated Battle" theories of the Soviet and American military forces are not only mindful of the realities of hostile confrontations on European battlefield and of the trend of what could possibly develop, but are directed particularly against the warfare methods of the enemy by establishing specific countermeasures and engaging in lateral studies, while, more importantly, also most realistically engaging in vertical studies, thus gaining nourishment from their own military inheritance. The Soviet army's present "great-depth operations" theory is not only an extension of World War II warfare experiences, but bears also the deep imprint of the "great-depth operations" warfare of the 1930's, while its embryonic form could be discerned in the "fighting with large masses of troops" theory of the 1920's. Early in the 1980's, the American military came out with the "Air-Land Integrated Battle" theory, first engendered in the practical experiences of World Wars I and II, of the Korean War and the Vietnam War. In the American warfare of long-distance interdiction in World War II, one can find traces of the "Air-Land integrated" fighting and the idea of "deep strike." Its ghost can also be found in the war of strangulation practiced by the Americans in the Korean War, while the "leapfrog tactics" and the "iron hammer and anvil" tactics at the two battle of Pleiku and Khe Sanh in South Vietnam were the first buds from which the "Air-Land Integrated Battle" theory directly originated and developed. The American and Soviet operations theories of the 1980's were not only products of the "enemy—myself—friend" lateral study, but also a result of the vertical study of two paths, namely "history—present—future" and "strategy—operations—tactics" lines.

China is a developing socialist country, also an ancient civilized country with a splendid culture. The "Sunzi's Art of War" is the world's oldest book on strategy, in which strategy and tactics are blended together, and which up to the present still commands the respect in every country of the world as a great classic. Through the practice of ages of warfare, this work has become a unique and original piece of military cultural tradition. It is worlds apart from the European-American tradition. Many famous Chinese strategists have never stuck to one particular form of combat deployment, but rather held to the opinion expressed in such sayings as: "Just as

water retains no constant shape, so in warfare there are no constant conditions," "the odd and the regular follow each other," "there is not only one way to win victory," and "the clever application depends on one determined mind." They believed that the ways to defeat the enemy with resourcefulness are "inexhaustible as Heaven and Earth, and unending as the flow of rivers and streams." This tradition evidently differs from that of European and American strategists. In the West, from ancient times to today, some did indeed also advocate resourcefulness to win victory, but many more placed emphasis on time and space as objectives of battle deployment. From square deployment, lateral deployment, and oblique deployment, trench systems, strong point deployment, right down to great-depth three-dimensional warfare, and "Air-Land Integrated Battle," all are permeated with the ideas of giving priority to material over man, and priority to technology over resourcefulness. They have all along emphasized the fighting of open and aboveboard conventional wars. Their operations theory is prone to take deployment as comprising theoretical principles, and form as comprising theoretical content. This is quite contrary to China's national tradition. In the process of studying Chinese military theory we must, therefore, go far back to recover the excellent military cultural tradition of the Chinese nation, and in the same way as the revolutionaries of the older generation, make the past serve the present. On the foundation of the national tradition which we have inherited, we must create a new operations theory that is suited to China's national condition.

Since the fighting at Jinggang Shan up to the recent counterattack against Vietnam, Chinese armed forces have all along emphasized the need to concretely analyze specific conditions, to fight the kind of action that is suited to the particular situation, to fight the kind of action for which weapons are available, and never to stick to one specific combat formation. For several decades, during the revolutionary war and fighting to defend the shores of the motherland, China's armies have fought over 100 battles of different scope and different patterns. Although these battles all had their peculiarities due to the different historical conditions and changes, and due to different strategic policies, they were battles of people's war, mostly fought with weapons and equipment that was inferior to that of the enemy, using alternately, in a mobile and flexible way, such diverse forms of warfare as guerrilla warfare, mobile warfare, and positional warfare. These facts clearly reveal the special characteristics of our army's tactics, namely initiative, flexibility, mobility, capability to take the offensive, speed, and capability of launching surprise attacks, which altogether shape our army's operations theory. This theory is characterized by having mobile warfare as its major form of warfare, while wars of quick decision and wars of annihilation are its main types of war. In Mao Zedong's military writings and several telegraphic directives, the special historical characteristics and principles of our army's warfare are accurately summarized and scientifically reflected; they are the

quintessence of the Chinese army's operations theory. We must carry them on and develop them further.

The future of every army is the extension of its past and present. With ourselves as main actors, the only correct way to establish an operations theory and basic guiding ideology for our army is to create and develop it on the foundation that has been bequeathed to us. Development and creation without regard for the excellent tradition that we have inherited can only be like cutting the foot to fit the shoe, i.e. accepting something uncritically and acting merely according to a conventional pattern. The quintessence of Mao Zedong's military thought is the conscious use of dialectical materialism and historical materialism as guides in war. This doctrine started out from the realities of the Chinese revolution, in a realistic manner recognized and mastered the objective rules of the Chinese revolutionary war, and on the basis of the excellent Chinese military culture bequeathed to us, created the treasure house of China's unique military theory. This "inheritance" is in the first place the passing on to us of this valuable asset. However, we have to recognize that all operations theory is the summary of practical warfare experiences under certain historical conditions, and is conditioned by the historical conditions of those experiences. The warfare of the future will be quite different from historical warfare. We must not mechanically transfer the warfare experiences of the past for use in the warfare of the future, but rather earnestly study the new conditions and new characteristics of warfare under the new historical conditions, draw on the experiences in our traditions, explore new warfare principles, and provide guidance for the warfare of the future.

## **2. We Must Implement the Resolution Passed by the Central Military Commission on the Strategic Shift in Guiding Ideology for Army Building, We Must Pursue Studies of Guiding Principles for Limited Wars**

The enlarged session of the Central Military Commission in 1985 decided on a strategic shift in the guiding ideology that is to govern our military development. This was an important historical change, a major event which has an impact on the future of our state and army, and will constitute the basic directive for all military undertakings for a long time to come.

For an extended period of time, we have stood under the influence of a guiding ideology of "war is soon to come, it will be a big war, it will be a nuclear war." In our studies of operations theory we, therefore, started out with preparations for the "big war," and took the strategic battles fought at Stalingrad or for the capture of Berlin as principal topics of our study. We were thinking of a very long duration of fighting, in which several hundred thousand to over one million soldiers would be involved on both sides; our studies had as background masses of front armies locked in decisive battle. In our concept and idea of a blueprint of the future operations theory, we were not yet able to free ourselves from the



influences of the form, scope, and configurations of World War II, and we neglected to study the guiding principles in the military operations of the more than 100 limited wars fought since World War II. The study of operations theory kept turning round and round on the one axle of the "big war."

In December 1986, Vice Chairman [of the Military Commission] Yang Shangkun said at the enlarged session of the Central Military Commission: "After many years of observation, Chairman Deng Xiaoping has come to believe that a world war cannot for the time being be fought, and that we shall be able to enjoy a relatively long period of a peaceful climate. With forces for peace growing increasingly stronger, a world war can possibly be avoided. This is a scientific assessment; it is a development of the Marxist doctrine on war." Although a "big" world war cannot be fought for the time being, several regional conflicts have uninterruptedly taken place all this time, and the regions around China too have not been peaceful. This is not only an imminent threat to China's national defense and four modernization projects, but contains a concealed threatening potential. China's armies are facing arduous and complex strategic tasks in that they have to consolidate national defense, withstand pressures, restrain divisiveness, defeat provocations, halt extension of hostilities, and eliminate all threats. This is the real and very important task that our military are faced with in their efforts to work out an operations theory. Efforts by our military to work out an operations theory will have to be pursued according to the strategic demands of the country and the strategic tasks that will have to be faced in future; this operations theory will be a contribution for which they cannot shirk responsibility.

Since the founding of the PRC, our armies have been tempered in actual war operations in the War to Resist U.S. Aggression and Assist Korea, in the counterattack at the Sino-Indian border, in Sino-Soviet border clashes, and in the counterattack against Vietnam. They have engaged in warfare of different dimensions and patterns, in different regions, and against different enemies. They have thus gained abundant experiences in limited wars. However, because study of operations theory had in the past laid particular emphasis on a background of total war, these studies appear to have been rather weak on the subject of guiding principles for limited war operations. This is somewhat inconsistent with the demands that are now made after the strategic shift in the guiding ideology in our military development. Discussing in depth the guiding principles of limited war operations conforming to Chinese conditions is, therefore, a demand of the time, a realistic task of our military, and a necessity in the historical development.

In the several decades since the war, over 160 limited wars have occurred all over the world. In recent times, theoretical studies of limited warfare have become quite popular. Surveying all previous outbreaks, progressions, and final results of limited wars, they appear indeed

quite different from total war. Especially since the 1970's, in the wake of scientific and technological developments and changes in weaponry and equipment, limited warfare has shown spectacular new features. First, in its diversity. Because of the great differences in the nature, objectives, scopes, and patterns of previous wars, warfare direction has had its particular traits in each single case. Looking at the nature of these wars, we see that some are domestic revolutionary wars, some power struggles between religious factions or groups, some are wars of national liberation in colonies, some are the aggressive wars of hegemonistic outward expansion, and some are territorial disputes between newly independent nations. Looking at the objectives and the scope of wars, we see that all these previous limited wars were scattered and unevenly spread over more than 60 undeveloped countries and territories, with great diversity in the objectives and the nature of interests being fought over, and of the military forces engaged, while their extent and duration were extremely limited. Looking at the pattern of warfare, we see that some are lightening attacks, executed in one spurt like a "surgical operation," some going to the length of encirclements, driving in from several directions for a war of encirclement and annihilation, and then there are also a few wars that are long drawn-out stalemates (the Iran-Iraq War). If we go by the practical experiences of previous Sino-foreign limited wars, and also by the objective realities of China's neighboring regions, China's armies will have to fight future limited wars on different types of terrain and against different kinds of enemies, fighting wars of different types, of different scopes, and of different patterns. In their warfare they should be guided by the principle: "As the enemy changes, we shall make a corresponding change; as the terrain changes, we shall change our tactics; victory cannot always be won in only one way." In working out a theory of limited warfare for our armies, we must avoid by all means trying to achieve uniformity in the warfare pattern, and we must guard against indiscriminately applying one fixed rule. The diverse nature of limited wars demands that we arrive in our efforts to work out an operations theory for our military at a large measure of flexibility and applicability. Second, is their proclivity for quick results. In the two world wars of the past, the two opponents threw all their human and material resources into the fight. They fought a protracted life-and-death struggle until one side was prostrate and had to surrender when all its financial resources and all its strength had been exhausted. Several dozen years later, in the wake of scientific and technological developments, the drain on resources in war has increased on an unprecedented scale. In the fourth Middle East War, the three participants, Egypt, Syria, and Israel, expended an average of over \$300 million a day. For this reason, armies of all nations of the world are today most eager to fight wars with lightening speed, to fight quick wars with quick results. The U.S. strike against Libya was a successful experiment. They concentrated a force of 3 aircraft carrier formations and over 250 aircraft, attacked in several waves over the whole target area for a very short duration, and immediately

withdrew after accomplishing their mission. The result was that, paying a small price, they had achieved a show of military force, a shock to Qadhafi, and had raised Reagan's prestige. This kind of brief and fast military action has left us with certain reference data for a study of future similar combat. China's future weaponry and equipment, its strategic tasks, and its opponents will be different. It is, therefore, obviously not possible to copy indiscriminately the experiences of the U.S.-Libyan conflict. However, for limited wars under present-day conditions, it is certainly beneficial for the formation of our own army's operations theory, to draw a lesson from the experiences of foreign armies, and to adopt their principles, by aiming at limited war objectives, by staging lightning attacks with quick combat and quick results, and by avoiding at all cost protracted wars. Third, is their high tech nature, namely having picked troops execute war tasks mainly with reliance on high tech equipment. Looking at modern limited wars, especially recent limited wars and armed clashes, we see that although they were of limited scope, equipment and technologies used were of a highly advanced nature. Looking again at the weaponry, equipment, and technological instruments used, we see that, with the exception of nuclear weapons, what was used were highly sophisticated technologies, such as the most advanced aircraft, warships, guided missiles, and directed energy weapons (including weapons using laser beams, particle accelerators, and microwaves), kinetic energy weapons, artificial intelligence weapons, biological weapons, infrasound wave weapons, and satellites. In past limited wars of different types, some of these weapons were widely used, some were used as initial experiments. As a consequence, combat in modern limited wars will become a high tech confrontation. In these types of combat operations, the most crucial role for their successful progression and result will be played by the most advanced means of reconnoitering and monitoring of the battlefield, by precision-guided weapons, and by electronic countermeasures. In working out an operations theory for our military, especially as regards the direction of limited warfare, it is necessary, on the one hand, to firmly base ourselves on what equipment is presently available, and to consider what future developments could possibly be, and on the other hand, to observe attentively all new developments and new tendencies on the international stage. Precisely as some people have predicted, limited wars have become an "arena of fierce rivalry," where the results of modern science and technology are being exhibited. Limited wars have many substantial and brand-new peculiarities which are worth our while to study and explore. Placing the guiding principles for limited war as an important item on the order of the day is something that cannot brook any further delay.

### **3. Effect Overall Planning, Scientifically Determine a System of Operations Theories for China's Military**

The "Cihai" dictionary defines the word "system" as "an entity composed of certain things linked together and interacting with each other." Following the establishment of system science and the use of systems

engineering, mankind has gradually progressed in the study of the diverse, complex, and limitless universe from the reduction method to the more scientific systems method, and as a consequence produced the a scientific methodology for the study of operations theory. The developmental changes in types and patterns of warfare have promoted a more profound study of operations theories; they demand, in macroscopic respects and in its entirety, that the system of operations theories be subjected to overall planning and overall study, as the only way to avoid the defect of acting with a restricted vision and shallow understanding, also as the only way to gain a clear idea of the framework and composite levels of the system of operations theories, its inner connotations and outward extensions, a clear idea of the various elements in the system of operations theories, and their interrelation and interaction, and arriving as a result at an integration of our operations theory with the objective reality.

Operational art is an integral part of our army's military science. It is the science studying the theories and practices of conducting warfare by the various service arms and campaign army groups. The object of its study are the various types, scopes, and pattern of military operations. Its task is to inquire into and study the principles of modern warfare, to determine and prepare methods for actual combat operations, for their coordination, and to ensure their success, to study and determine the composition of army groups, and to study the command and control exercised by senior officers and headquarters of combat troops during the entire process of the battle, and the ways that will ensure overall success.

Operational art is an important integral part of military science, and also a subsystem of military science. It is interrelated, mutually permeating, and interacting with the study of strategy, tactics, military command, and military logistics. Operational art is a relatively young and also independent field of study, evolving from the development of science and technology and of new weapons and equipment, and is changing in accordance with the changes of war. It is a system of its own, with its specific scope, special features, content, levels, and principles. It is conditioned and influenced by the study of strategy, and again linked with the study of strategy, as it also influences and conditions strategy. In our studies of operations theories, we must, therefore, on the one hand, take it as an independent system, pay attention to study the inherent connections in operations theories, and on the other hand, accurately handle its position in the field of military science; we must study and gain knowledge of the basic principles of the operations theory by approaching it from the angle of the entire system of military theory and from the height of strategy.

Operational art as a relatively independent, completely structured, clearly graded system, is in the main composed of two sections: study of basic operations theory and study of applied operations theory. The study of

basic operations theory studies the general directional principles within the scope of military operations; it is the theoretical summation of the general principles of combat. It mainly comprises definition and nature of combat, the onset and progression of combat, the main features of combat and its main categories, the general rules and basic principles of combat, and the developmental trends and main achievements in the study of operations theories by the military of foreign countries. The study of applied operations theory studies the changes in present as well as future combat conditions, the general principles of applying basic operations theories, and the theoretical principles of organizing and executing military operations. It mainly comprises the basic guiding ideology of military operations in total as well as in limited wars, the organization and composition of army groups for military operations, the types, scope, and special features of combat as possibly faced in future, the special combat methods of the enemy and countermeasures by our troops, methods and principles of combat preparations and their execution, mobility of combat, deployment and command, coordination of military operations and ensuring their success, political work in military operations and training just before combat. Basic operations theory and applied operations theory are interrelated and interacting, and neither can do without the other, but they also differ, each having a different structure and levels. We must, on the one hand, in macroscopic respects, comprehensively and systematically study their systems structure, and on the other hand, in microscopic respects, objectively and thoroughly study their inherent principles. In addition, the system of operations theories is a dynamic structure, and we must continuously correct, develop, and deepen research results in actual practice, truly establish a perfect, scientific, and advanced system of operations theories with the special characteristics of the Chinese military.

Modern warfare makes many more demands on military operations, but also bestows on military operations a higher status. Pursuing the study of the operations theory of our military in greater depth is a demand of our times and the unshirkable responsibility of our scholars of military science. Out of a desire to develop a modern operations theory for our military, we are herewith putting forward some humble ideas, inviting everybody's advice and hoping to receive criticism and corrections from all our comrades.

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#### **Caution Urged in Attacks Deep Behind Enemy Lines**

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[Article by Army Chief of Staff Zheng Shouzeng [6774 1343 1073]: "My Thoughts on the Selection of Campaign Targets"]

[Text] The term campaign target is usually used to mean the main targets to be attacked and the places to be stormed and occupied during operational combat, i.e.,

the central points at which power is employed. Accuracy in the selection of campaign targets holds important significance for winning victory in a campaign. With the espousal in recent years of "in-depth attack" theory, an intense controversy has taken place throughout the armed forces about the selection of campaign targets. Some people maintain that attacks on combat troops deployed in the front line (or close range targets, for short, by which is meant targets within the rear of the enemy's and our own tactical formations) should be paramount; others maintain that attacks on the command system, firepower system, electronic warfare system, and rear area support system targets deep behind the enemy's troop deployments (or in-depth targets) should be paramount. This article analyzes several aspects of this issue by way of explaining my own basic standpoint and views.

#### **1. The Effect on the Overall Campaign Situation of Attacks Against In-depth Targets and Close Range Targets**

It is of utmost importance in selecting campaign targets that the selection help in the attainment of campaign objectives, meaning that in an offensive campaign the selection has to help wipe out enemy forces, and that in a defensive campaign it has to help frustrate an offensive by enemy forces. Inasmuch as contradictions within anything are never equal, so it is that targets to be attacked first also differ, and positions and roles in the attainment of campaign objectives also vary. Therefore, when campaign commanders draw up campaign plans, they should strive to make the main targets of attack in the campaign those targets that can have a decisive influence on the progress and outcome of the campaign.

During the course of campaign combat, from the standpoint of the attacking side, strikes should be made against close range targets to smash the enemy's front line resistance and to open breaches in the enemy's defensive deployments. This not only has a bearing on completion of the mission of the moment, but it will also decide, to a very great extent, the smoothness with which the entire campaign's in-depth offensive develops and attainment of the campaign's ultimate objectives. Foreign armies see an attacking military forces as a "surging flood," and they see the defending side's front line of resistance as a "dam" that blocks the flood. They believe that all that is necessary is to open a breach in the "dam," and the "flood" that is the attacking army can go through the breach and "roll on" "destroying everything." Reasons for stressing the position and role of close range combat in offensive campaigns are as follows: First, modern defense is in the nature of defensive rings at many locations and in many directions. As a result the attacker cannot outflank or drive through gaps at any time. Second, inasmuch as the defender also has powerful firepower and is able to inflict heavy casualties on the attacker, the attacker cannot use firepower in all directions to suppress the defenders and then begin an attack using mobile forces. Third, even if the attacker employs



destructive weapons of tremendous power, he cannot expect to achieve victory easily. This is because the defender can use extensive mobile reserves as well as troops and weapons that have not yet come under attack and from secondary directions to wipe out quickly the results achieved by attacks. Therefore, one can say that at no time can attacking forces expect to pass through the opponent's defenses without being blocked. This means that in the future, in order to overcome a defending enemy's resistance, the attacker will have to deploy in combat formation for repeated attacks against the enemy's positions. For defenders, the significance of attacking close range targets first lies in the follows: First is to delay and slow down the speed of the enemy offensive in order to gain time for completion of defense preparations. Second is to inflict large numbers of casualties on the enemy's effectives, to weaken the enemy's crack troops, and to change gradually the unfavorable balance of strength, thereby turning the combat situation into a favorable direction. Third is both to smash enemy efforts to turn a tactical victory into a campaign victory, causing unevenness in the enemy's development of the offensive to adversely affect the enemy's offensive plans for the entire campaign, and to use the uneven development of the enemy's offensive to concentrate superior troops and weapons to attack and destroy routes of enemy attack in order to bring about a rapid change in the overall defensive situation after which, if circumstances warrant, the defenders can go on the offensive at the right time to defeat the enemy.

Despite the steady increase in the position and role of in-depth combat under modern conditions, attackers have not abandoned the principle of committing main forces to a frontal assault. In order to maintain an absolute superiority in the ratio of their first echelon troops against a defender, some foreign armies use powerful attacks to break through the hard "outer shell" of the opponent's front line defenses in one fell swoop, and in order to develop a high speed offensive deep in the operational rear, troops in the first echelon of the campaign army group frequently numbering between one-half and two-thirds of total forces, while the number of troops used in in-depth combat number only 20 percent of the total. In the use of firepower, though the percentage of casualties inflicted from long range firepower is on the rise, casualties continue to be concentrated in the tactical rear, and the time when firepower is being used for softening up is when greatest casualties are inflicted. It is recommended that before launching an assault, damage and injury to the enemy should reach between 30 and 40 percent, and damage and injury to enemy front line defense forces and equipment should reach between 50 and 60 percent. The goal of such "heaviness up front and lightness toward the rear" in campaign deployments and the use of firepower is to wipe out the opponent's defense system in the first attack. It reflects in a concentrated way the goal of making first strikes decisive in modern offensive campaigns. Obviously, the central focus of struggle between adversaries in future campaigns will be on close range

targets, not on targets deep in the rear. The targets to be attacked and wiped out will be close range ones, not targets deep in the rear. Unless the problem of close range targets is solved, neither the side that is on the offensive nor the side that is on the defensive will likely be able to attain its campaign objectives.

## 2. Comparison of Strengths and Weaknesses of Close Range Targets and In-depth Targets

Attacking weak points and avoiding strong ones is an important principle in the selection of campaign targets. Consequently, before deciding on campaign targets, a comparative analysis should be made of the strength and weakness of targets. In terms of systems theory concepts, both in-depth targets and close range targets are integral parts of the enemy's campaign deployments, and are closely related to all campaign essential elements and the battlefield environment. Therefore, when we compare the strength and weakness of the two kinds of targets, we cannot separate them from other campaign essential elements and the battlefield environment. It is suggested that one very important basis for attacking either mostly in-depth targets or soft targets during battle in a campaign is as follows: When in-depth targets are more poorly protected than close range targets, an attack on them will more easily succeed. Obviously, such a comparison of one target with another in isolation is lopsided and unscientific. If we make an overall analytical comparison of all campaign essential elements and the battlefield situation pertaining to both in-depth targets and close range targets, we might realize that those in-depth soft targets are not absolutely the best ones to attack nor can they be taken so easily.

Because of the importance to campaign movements of the command, firepower, electronic warfare, and logistic support systems, all the armies of the world devote serious attention to the defense of important targets deep in the rear. In order to insure uninterrupted command and support of campaign combat, they take a series of measures to protect major targets in the rear. These measures may be characterized as follows: (1) Strictness of defensive measures. First is dispersal of deployments. In order to reduce the amount of damage and casualties from enemy air raids, all the units that make up campaign army groups disperse their deployments at numerous points several kilometers or more from each other. Second is movements at the right times to shorten the time that command organizations remain at any given place. Third is the construction of fortifications, carefully camouflaging them, and doing all possible to reduce discovery by the other side and their probability of being destroyed. (2) Emphasis on total protection. First is organization of troops to guard and protect important targets and communications lines and to provide protection against air attacks. All troops in the campaign rear can be readied to fight for the rear. Second is that the campaign's second echelon and reserves is to be responsible not only for assisting the first echelon's combat

mission, but also is responsible for the mission of protecting important targets in the rear. The command, firepower, electronic warfare, and logistic support systems usually are based in the areas of deployment of the second echelon and the reserves. The guarding and protection of command posts is not only the responsibility of guard and reconnaissance detachments, but sometimes it is also necessary to get the participation of detachments from the second echelon and the reserves. Third, when in-depth targets face a threat, both artillery troops and airmen can provide effective firepower support, a combination of firepower mobility and troop mobility making decisive blows against the attacking enemy. (3) Strong adaptability. In order to support uninterrupted command, campaign army groups usually set up a basic command post, an auxiliary command post, a reserve command post, and a rear area command post, plus one or two observation posts, and deploy echelons in depth as the combat situation requires. Echelon deployment command posts make it difficult for the enemy to determine the location of the command post and lower the possibility of enemy air attacks on it. In addition, they insure that command will continue to be exercised when campaign commanders must move from one command post to another command post.

The objective of attacks on in-depth targets is to disrupt the enemy army's timing and to smash its whole campaign performance. However, the foregoing analysis shows that it is more difficult to strike in-depth targets first than to strike the enemy's close range targets. An American army analysis holds that in past wars and in recent limited wars, when a division's casualties have amounted to 30 percent of the total number of troops, the number of casualties in each service arm as a proportion of the number of troops in each branch of service was as follows: infantry, 30 percent; artillery, 12 percent; and others, 7 percent. The percentage of casualties in each service arm happens to be inversely proportional to the distance from the battle line of their place of deployment. This analysis helps verify this point of view from another angle.

### 3. Advantageous and Disadvantageous Conditions for Attacking In-depth Targets and Close Range Targets

Marxism holds that force is not purely an act of will; its success depends on the material means that the force employs. Consequently, when setting campaign targets, it is necessary to employ to the full all subjective activity and do everything possible to satisfy the needs of combat as a whole. At the same time, it is also necessary to proceed from realities, taking needs into account but taking capabilities even more into account, bringing into line both subjective command and objective realities.

During combat in a future campaign, since the enemy's weaponry will be superior to our own, there are greater disadvantages and we face greater difficulties in attacking in-depth targets first rather than attacking close range

targets. First, our ability to conduct long-range reconnaissance is limited making it difficult to obtain accurate information promptly about the enemy's in-depth targets. Thus, it is not possible for us to select advantageous combat opportunities to make effective strikes against enemy in-depth targets, and this would be bound to have a bad effect on results from in-depth attacks. Second, there is a very great gap between our aerial combat capabilities and ability to protect the ground from the air as compared with the enemy; the enemy will hold air superiority. Analysis of combat experiences in the protection of strategic points on the Korean and Vietnamese battlefields shows that a 24 percent or higher enemy aircraft destruction rate is necessary in order to protect troop units. Obviously, reliance solely on the antiaircraft weapons organic to campaign army groups will hardly insure the smooth movement of units attacking in-depth. When mobile ground forces lacking reliable protection against air attacks move over long distances toward the enemy's in-depth targets, they will certainly sustain serious casualties from enemy aerial firepower. Third, China has limited long-range weapons making it difficult to provide effective firepower assistance to forces attacking enemy in-depth targets. When forces attacking in-depth enemy targets lose fire support, their attacks will appear weak and ineffectual making it difficult to fight a quick battle that is quickly decided. Fourth, our mobility is poor, and this is bound to be disadvantageous for our seizing combat initiative. Initiative in combat against enemy in-depth targets depends on the surprise nature of movements and the ability to move rapidly to meet battlefield emergencies. Slow mobility inevitably means long maneuvering times. It is very difficult to avoid being spotted by the enemy if a long time is taken to make battlefield movements when the enemy is conducting close surveillance using technical reconnaissance devices. If the element of surprise is lost, success in in-depth attacks will be very difficult. In addition, when movement is slow, it is not possible to make a timely and effective response to battlefield situations. When the battlefield situation favors us, it is difficult to seize combat opportunities; when the battlefield situation does not favor us, it is difficult to get out of predicaments. Fifth, resupply is difficult in long range in-depth attacks against enemy forces making it difficult to carry out protracted combat. Because of our ability to conduct in-depth attacks, and the problems faced, large scale actions to attack and destroy in-depth enemy targets should not be taken in campaign combat.

By comparison with attacks on in-depth targets, because of the relatively confined scope of combat, attacks against close range targets make it possible to gain the following advantages: First is an advantage in understanding the battlefield situation and command control over combat movement, thereby increasing the accuracy, speed and effectiveness of decisions by campaign commanders. Second is an advantage in concentrating superior forces to form an attacking fist that can deliver powerful blows against the enemy at key times and places. Third is an advantage in making the most of the

close-range attacking capabilities of our available technical weapons, carrying out multiple attacks against enemy close-range targets. Fourth is close-range movement for a relatively shortening of the time required to move troops and equipment, thereby reducing enemy opportunities to inflict casualties on our forces using aerial and ground firepower. Fifth is an advantage in the stabilization of our rear area, particularly during a defensive campaign when close range combat makes it possible to gain more help from geographical conditions than in-depth attacks on the enemy. Priority can go to the selection of defense positions, and natural obstacles and permanent defense works can be used to shelter our forces where they can wait at ease to meet an exhausted opponent. It has advantages in conserving our own forces while inflicting larger casualties and attrition on the enemy. Defense has the advantage of conserving troops, of using small numbers to attack large numbers, and of using weak forces to overcome strong ones to gain rather ideal combat results.

Comparison of the effects on the campaign as a whole and analysis of the strengths and weaknesses of the two kinds of targets arrived at through the above discussion

of attacks on close range targets versus attacks on in-depth targets, as well as the analysis of advantages and disadvantages of close-range combat and in-depth attacks enables us to see without difficulty that attacks against close range targets can have a decisive effect on the progress and the outcome of a campaign. Second, close range attacks help make the most of advantages, and capitalize on strengths while playing down weaknesses to overcome the enemy and achieve victory. Therefore, close range targets should be the main targets of attack in a campaign. Because of the special nature of combat situations, the selection of campaign targets is affected by numerous elements and limitations. For this reason, the selection of campaign targets cannot be formatted; it has to take into account each campaign's different circumstances such as different campaign backgrounds, different combat objectives, different combat opponents, and different battlefield conditions, the targets for attack being selected on the basis of the situation at a particular time and at a particular place.

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